Supreme Court, U.S.
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No. 99 476

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In The

Supreme Court of the United States

VALENCE TECHNOLOGY, INC., CARL E. BERG, LEV M. DAWSON, CALVIN L. REED, DALE R. SHACKLE,

Petitioners,

vs.

JAMES I. BERRY; JAMES VARANO; GREGG M. WEISS; PETER GARUCCIO, M.D., P.C. PENSION PLAN; FREDERICK JEWETT; JILBURNE E. ESTES; JOSEPH P. YONKE; INVESTAR PARTNERSHIP; EUGENE HONEYMAN; ANNE KANTOR; MURRAY GOLDSMITH; MORTON SURKIN; FLORENCE SURKIN; ROBERT LEIMSIDER; GILBERT BERGELSON, on behalf of themselves and all others similarly situated,

Respondents.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Ninth Circuit

PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED

The statute of limitations for private claims arising under Section 10(b) of the Securities and Exchange Act of 1934 is one year from the "discovery of the facts constituting the violation" and within three years of such violation. *Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson*, 501 U.S. 350, 354 n.9 (1991).

What actual or constructive knowledge of the plaintiff is legally necessary to trigger the one-year limitations period?

RULE 29.1 STATEMENT

Valence Technology, Inc., does not have any parent companies, subsidiaries, or affiliates that have issued securities to the public. Valence stock is traded on the NASDAQ. Valtron Technology Pte. Ltd., is a Singapore corporation 40% owned by Valence Technology Cayman Islands Inc. (a wholly owned subsidiary of Valence Technology, Inc.) and 60% owned by Goldtron, Ltd., through its Cayman Islands subsidiary. Hanil Valence Co., Ltd., is a Korea corporation 50% owned by Valence Technology B.V. (a wholly owned subsidiary of Valence Technology, Inc.) and 50% owned by Hanil Telecom Co., Ltd. Alliant/Valence, L.L.C., is a Delaware limited liability corporation 50% owned by Valence Technology, Inc., and 50% owned by Alliant Techsystems Inc.

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PETITION FOR WRIT OF CERTIORARI

Valence Technology, Inc., Carl E. Berg, Lev M. Dawson, Calvin R. Reed and Dale R. Shackle petition for a writ of certiorari to review the judgment of the United States Court of Appeals for the Ninth Circuit.

OPINIONS BELOW

The opinion of the United States Court of Appeals for the Ninth Circuit is reported at 173 F.3d 699 (1999) and is reprinted in the Appendix to this Petition at App. 1, *et seq.*

In the District Court, the motion for summary judgment of petitioners/defendants was referred to a Special Master. The Special Master recommended that summary judgment be granted to the defendants on July 14, 1997. The Special Master's recommendation is reprinted at App. 39, *et seq.* The District Court adopted the recommendation of the Special Master and granted summary judgment in an opinion dated November 5, 1997. Judgment was entered November 6, 1997. App. 19. The opinion of the district judge is reprinted at App. 21, *et seq.*, and is published at 987 F.Supp. 796 (N.D. Cal. 1997).

JURISDICTION

On April 29, 1999, the United States Court of Appeals for the Ninth Circuit filed its opinion affirming the District Court in part and reversing in part. Petitioners filed

a timely petition for rehearing and suggestion of rehearing *en banc* on May 24, 1999. The Court of Appeals denied the petition on June 18, 1999. App. 63-64.

This Court's jurisdiction rests on 28 U.S.C. § 1254(1).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

The principal statutory provisions involved are 15 U.S.C. §§ 78i(e) and 78j, *i.e.*, Sections 9(e) and 10 of the Securities Exchange Act of 1934.

Section 10 provides, in pertinent part, that "It shall be unlawful for any person, directly or indirectly, . . . [t]o use or employ, in connection with the purchase or sale of any security registered on a national securities exchange . . . any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors." 15 U.S.C. § 78j.

Section 9(e) provides in pertinent part that "No action shall be maintained to enforce any liability created under this section, unless brought within one year after the discovery of the facts constituting the violation and within three years after such violation." 15 U.S.C. § 78i(e).

In *Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson*, 501 U.S. 350 (1991), this Court held that the language of the limitations provision of Section 9(e) governs the timeliness of private civil actions commenced under

Exchange Act Section 10(b), 15 U.S.C. § 78j(b). 501 U.S. at 364 n.9.

STATEMENT OF THE CASE

Petitioners are Valence Technology, Inc. ("Valence") and certain of its current and former officers and directors. Valence was started in 1989 to develop a potentially revolutionary battery technology. Valence made an initial public offering of its stock in May, 1992, and a secondary public offering in November of that same year. App. 4.

In December, 1992, Valence announced an agreement with communications giant Motorola, Inc., pursuant to which Motorola agreed to purchase up to $100 million of Valence batteries meeting Motorola's specifications. App. 4. Valence announced the agreement with the statement "the significance of the Motorola agreement can't be overestimated." App. 35. All did not proceed as hoped, however, despite an infusion of capital from a third public offering. App. 43. On May 3, 1994, Valence announced that it was unable to produce batteries meeting Motorola's then-existing requirements.

Literally within hours of this announcement, respondents (Valence shareholders) began to file class action lawsuits alleging securities fraud. Respondents charged that the statement "the significance of the Motorola agreement can't be overestimated" was fraudulent; Valence had overstated the significance of the Motorola agreement, the state of Valence's technological development, and Valence's ability to manufacture batteries satisfactory to Motorola – all for the purpose of artificially

inflating Valence's share price for the benefit of Valence "insiders" who were "unloading" shares in the company. App. 22, 35.

These allegations would have a familiar ring to anyone who had read an article in *Forbes* magazine published over fifteen months earlier. In mid-February, 1993, *Forbes* published an article on Valence, entitled "Story Stock." App. 5. "Look closely" implored *Forbes*. "[I]f you believe the story that goes with Valence," there were a few things you probably did not know. App. 23-27. According to *Forbes*, "insiders" (naming petitioners Dawson and Berg) and investment bankers (naming the investment banking firm Montgomery Securities, a former defendant in the District Court) were accused of "energizing" the stock of "a company whose main asset . . . is an unproven technology" with a combination of unfounded earnings projections, "scientific-looking" diagrams and "a good show." App. 24. The company's claims about its technology had been given the false authority of independently verified fact by a scientist who was paid by Montgomery and merely relied on Valence. App. 25, 58-59. Meanwhile, the insiders, including one "accused of securities fraud," were "unloading shares for a price hundreds of times what they paid." App. 23-26. *Forbes* suggested that Valence had also misrepresented the significance of the Motorola agreement. It was "much less than meets the eye;" Motorola had "merely agreed to buy batteries if Valence can build them cheaply enough and if the batteries work." App. 25. Investors who bought Valence's "story," however, had bid its share price to "outlandish levels." App. 56.

In the District Court, petitioners moved for summary judgment, including on the ground that respondents'

complaint was untimely in the light of the fifteen-month-old disclosures in *Forbes*. App. 7. The District Court referred the motions for summary judgment to a Special Master, who recommended a finding that respondents' claims were, indeed, time-barred, because they had been filed more than a year after plaintiffs were placed on inquiry notice of possible fraud by the disclosures in *Forbes*. App. 39-62. The District Court agreed after *de novo* review, and granted summary judgment for petitioners. App. 21.

Respondents appealed. The Ninth Circuit reversed in pertinent part, holding that even what it viewed as "the article's most provocative claim – that a 'curious merry-go-round of insiders, underwriters and journalists . . . keeps [Valence's] stock spinning' – challenged the enthusiasm and hype heaped on the product by the industry, not the honesty or good faith of Valence's leaders." App. 13-14. The opinion did not elaborate on the apparent distinction between the "insiders" referred to by *Forbes* and "Valence's leaders" referred to by the Court. Moreover, unlike the Special Master and the District Court, the Ninth Circuit apparently did not consider suspicious *Forbes'* disclosure that "insiders" who had been "accused of securities fraud" were "unloading" their shares in Valence. *Compare* App. 13-14 *with* App. 34, 57.

The Court of Appeals concluded that, as a matter of law, no reasonable person could possibly draw from the facts asserted in *Forbes* the suspicion that Valence's claims about its battery technology or, apparently, its agreement with Motorola, might be fraudulent, no matter what theory of notice might apply. App. 15. *Forbes*, the Court

observed, "made no allegation of actual fraud." App. 12. The Ninth Circuit further relied on three supporting facts: First, "the market exhibited little reaction to the article," as shown by subsequent movement in Valence's stock price. Second, "other press coverage of Valence remained largely positive." Third, Valence's chief executive wrote a letter to *Forbes* disputing the article. App. 14-15. The panel concluded, "given the lack of any notable adverse market reaction or negative press follow-up, it would have been reasonable for a shareholder to read [the executive's] letter and to conclude that nothing was amiss." App. 15. Thus, the contents of the *Forbes* article could provide neither actual nor inquiry notice of fraud.

In view of this conclusion, the Ninth Circuit professed not to decide on the legal standard triggering the statute of limitations on Section 10(b) claims. But in reality, the Court added to, and highlighted, two conflicts that exist in the Circuits on this important issue.

1. According to the Ninth Circuit, "in applying section 9(e)'s limitations period to actions under section 10(b), *Lampf* explicitly chose a provision requiring actual discovery over other provisions allowing inquiry notice." App. 9. The Ninth Circuit understands *Lampf* to have acknowledged this specific difference between such provisions, "and [this Court] was clear about its choice." App. 9. The explicit clarity of this Court's opinion, however, has not been perceived by seven other Circuits, each of which has held that *Lampf* permits some form of inquiry notice to commence the limitations period. The Ninth Circuit thus took open exception with "every circuit to have addressed the issue since *Lampf*," App. 9-10, agreeing, in substance, with a pre-*Lampf* decision of the

Third Circuit endorsing "actual discovery" as the limitations trigger.

2. Those Circuits applying an inquiry notice standard disagree in a significant respect on the legal formulation. For some, the period of limitations is triggered, and commences to run, once the plaintiff has or should have sufficient information to cause a reasonably prudent person to investigate the possibility of fraud. *Dodds v. Cigna Securities, Inc.*, 12 F.3d 346, 351 (2d Cir. 1993), *cert. denied*, 511 U.S. 1019 (1994); *Cooke v. Manufactured Homes, Inc.*, 998 F.2d 1256, 1263 (4th Cir. 1993). Another variation places "discovery" at the point at which a plaintiff knows or should know facts sufficient to induce an investigation that would uncover enough other facts to enable that plaintiff to sue within a year of learning the facts that induced the inquiry (and thus constitute the "discovery"). *Fujisawa Pharm. Co., Ltd. v. Kapoor*, 115 F.3d 1332, 1334 (7th Cir. 1997). Others, including this Ninth Circuit panel, allow an investor additional time to conduct an investigation sufficient to allow a reasonably diligent investigator to discover the facts "underlying" the allegedly fraudulent activity, commencing the one-year period only at the point at which the investigation should have assembled those facts. App. 11; *Sterlin v. Biomune Systems*, 154 F.3d 1191, 1201 (10th Cir. 1998).

REASONS FOR GRANTING THE WRIT

Lampf, 501 U.S. 350, adopted a uniform, federal statute of limitations for actions arising under Section 10(b).

A one-year limitations period is triggered upon the "discovery of the facts constituting the violation." 501 U.S. at 364 n.9.

The uniformity sought from a federal rule, in place of the prior regime of borrowed state law, has been disturbed by two Circuit conflicts that have developed and can be resolved in this case.

A. In the wake of *Lampf*, the Courts of Appeals in the Second, Fourth, Fifth, Sixth, Seventh, Eighth, and Tenth Circuits have all concluded that the language drawn from Exchange Act Section 9(e) was not intended to, and did not, displace the general rule that "inquiry notice" of the alleged fraud suffices to commence the running of the limitations period. *Kahn v. Kohlberg, Kravis, Roberts & Co.*, 970 F.2d 1030, 1042 (2d Cir.), *cert. denied*, 506 U.S. 986 (1992); *Howard v. Haddad*, 962 F.2d 328, 330 (4th Cir. 1992); *Topalian v. Ehrman*, 954 F.2d 1125, 1134-35 (5th Cir.), *cert. denied*, 506 U.S. 825 (1992); *Ockerman v. May Zima & Co.*, 27 F.3d 1151, 1155 (6th Cir. 1994); *Tregenza v. Great American Comm. Co.*, 12 F.3d 717, 721-722 (7th Cir. 1993), *cert. denied*, 511 U.S. 1085 (1994); *Great Rivers Co-op. v. Farmland Indus., Inc.*, 120 F.3d 893, 898 (8th Cir. 1997); *Sterlin*, 154 F.3d at 1201-1202.

The Second and Seventh Circuits have explicitly held that "discovery," as used in Section 9(e), includes constructive and inquiry notice. *Menowitz v. Brown*, 991 F.2d 36, 41-42 (2d Cir. 1993); *Marks v. CDW Computer Centers, Inc.*, 122 F.3d 363, 367 (7th Cir. 1997).

In a decision rendered prior to *Lampf*, however, the Third Circuit had indicated that the language of Section 9(e) reflected Congress' deliberate choice of an "actual

knowledge" standard. *Gruber v. Price Waterhouse*, 911 F.2d 960, 964 n.9 (3d Cir. 1990). Adopting reasoning similar to that employed by the Third Circuit in *Gruber*, the instant Ninth Circuit opinion contends that "*Lampf* explicitly chose a provision requiring actual discovery over other provisions allowing inquiry notice." App. 9.

Certiorari should now be granted to resolve a circuit conflict on a question of importance, *i.e.*, what actual or constructive knowledge of a prospective plaintiff suffices to commence the one-year limitations period applicable to private claims arising under Exchange Act Section 10(b), and specifically whether inquiry notice of facts suggesting fraud does or does not constitute the "discovery of the facts constituting the violation."

B. Those Courts applying "inquiry notice" disagree over the proper legal standard. In the Second Circuit, the one-year period of limitations starts to run when the plaintiff knows or should know enough to commence an inquiry into the possibility of fraud. *Dodds*, 12 F.3d at 350. In the Seventh Circuit, "discovery" occurs "not when the fraud is discovered" but one year prior to the time that the plaintiff should be able, in the reviewing court's judgment, to file a non-frivolous complaint. *Fujisawa Pharm.*, 115 F.3d at 1334. In the view of the Tenth Circuit, adopted by the Ninth Circuit panel below, "discovery" triggering the limitations period occurs at some time *after* a prospective plaintiff is on inquiry of possible fraud. In these Circuits, plaintiff is given additional time to conduct such investigation as is reasonably necessary to discover facts underlying the alleged fraud. *Sterlin*, 154 F.3d at 1201; App. 11.

In effect, the Circuits take different views on the purpose of the limitations period, accordingly commencing it at different points. Some view the limitations period as the time to conduct the investigation called for by the suspicious facts that should prompt the inquiry. Others view the investigatory period as preceding the trigger of the limitations period.

C. Why is this case a suitable one to address these Circuit conflicts? Because under a traditional inquiry notice test, petitioners would have had, at worst, the opportunity to present a statute of limitations defense based on the *Forbes* disclosures to a jury, and at best, would have demonstrated (or at least would have the opportunity to demonstrate) that respondents' claims are time-barred as a matter of law.

The Ninth Circuit opinion thus presents a further issue for review in its application of the "discovery of the facts constituting the violation" test to the contents of the *Forbes* article. In determining that *Forbes* constituted neither actual nor inquiry notice of fraud, the Ninth Circuit concluded that the "article made no allegation of actual fraud." App. 12. In *United States v. Kubrick*, 444 U.S. 111, 117 (1979), this Court reversed the Third Circuit when it held that the statute of limitations on a Federal Tort Claims Act cause of action did not begin to run until the plaintiff knew or reasonably could have known that his injury was the legal result of medical malpractice, even though the plaintiff earlier knew that he had been injured and the likely source of that injury. It was error to equate "a plaintiff's ignorance of his legal rights and his ignorance of the fact of his injury or its cause." 444 U.S. at 122. Here, the *Forbes* article disclosed both the precise injury

alleged (artificial inflation in the price of Valence shares) and its likely cause (the "boastful" and unfounded pronouncements of the company, "insiders," and others riding a "curious merry-go-round" to profit from sales of the stock). App. 13, 23-24, 56. The Ninth Circuit has committed the same error, in suggesting that the "discovery of the facts constituting the violation" occurs only when "the facts" are presented clearly in the garb of "the violation" – here, a claim for securities fraud.

In concluding that the *Forbes* article could not possibly constitute notice, moreover, the Ninth Circuit also weighed facts extraneous to the facts contained in the article itself. Thus, *Forbes* could not have provided notice of fraud because the article did not elicit a severe, sustained, negative response from "the market" in the form of a lower stock price, because other media wrote "positive" stories on Valence, and because Valence's CEO later wrote a disputatious letter to *Forbes'* editor. App. 14-15. In other words, *Forbes* did not disclose "the facts constituting the violation" because: (a) the market did not "believe" what was in *Forbes;* (b) other media reported differently; and (c) a company executive took issue with the magazine's charges.

If the question is whether *Forbes* disclosed "the facts constituting the violation," however, then none of the things relied on by the Ninth Circuit panel should be relevant to that determination. The basic question implicated by a "discovery" test should be whether what was disclosed (and hence either discovered or discoverable) was later alleged to constitute fraud. This analysis was undertaken by the Special Master (App. 55-61) and by the District Court (App. 34-35), but honored only in the

breach by the Court of Appeals. App. 12-13 (remarking on the requirement of a "nexus" between the notice and the subsequent complaint). In the analysis of the Ninth Circuit, *Forbes* could not constitute notice because a prospective plaintiff investigating its claims *might* have concluded "that nothing was amiss." App. 15. In other words, whether the time to sue on a claim has begun to expire is not to be determined by the relationship between facts, known or available, and those subsequently alleged in a complaint to constitute fraud, but by the court's *post hoc* judgment about whether the sum of information available during and after the time the purported violation is disclosed would, on balance, induce a prospective plaintiff to investigate and then to sue. The Ninth Circuit has plainly linked the commencement of the one-year period to something other than "the discovery of the facts constituting the violation."

Because a statute of limitations operates to extinguish the rights of claimants, a fundamental consideration should center on the ability of prospective claimants (and their lawyers) to apply the statute prospectively. But a rule such as that employed by the Ninth Circuit cannot be applied prospectively by individuals attempting to determine whether the time for them to assert a claim is wasting, but only retrospectively by a court deciding whether or not a particular action, already commenced, will proceed. Such a standard is at odds with this Court's focus on the "discovery of the facts constituting the violation," is impractical, and injects an untoward measure of judicial discretion into the limitations question.

CONCLUSION

The petition for certiorari to the Court of Appeals for the Ninth Circuit should be granted.

DATED: September 16, 1999

Respectfully submitted,

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FOR PUBLICATION

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

JAMES I. BERRY; JAMES VARANO; GREGG M. WEISS; GREGG M. IRA, F/B/O/ WEISS; PETER GARUCCIO, M.D.; P.C. PENSION PLAN; FREDERICK JEWETT; MILBURN E. ESTES; JOSEPH P. YONKE; INVESTAR PARTNERSHIP; EUGENE HONEYMAN; ANNE KANTOR; MURRAY GOLDSMITH; MORTON SURKIN; FLORENCE SURKIN; ROBERT LEIMSIDER; GILBERT BERGELSON, on behalf of themselves and all otehrs similarly situated, *Plaintiffs-Appellants,* v. VALENCE TECHNOLOGY, INC.; LEV DAWSON; CALVIN L. REED; CRISTINE A. RUSSELL; DALE R. SHACKLE; DAVID M. BUTZE; WILLIAM J. MASUDA; CARL E. BERG; ALAN F. SHUGART; BERT C. ROBERTS, *Defendants-Appellees.*	No. 97-17346 D.C. No. C-95-20459 JW (EAI) OPINION

Appeal from the United States District Court
for the Northen District of California
James Ware, District Judge, Presiding

Argued and Submitted
December 9, 1998 – San Francisco, California

Filed April 29, 1999

Before: Myron H. Bright,* Betty B. Fletcher, and David R. Thompson, Circuit Judges.

Opinion by Judge B. Fletcher

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Tower C. Snow, Jr., Brobeck, Phleger & Harrison, San Francisco, California, for defendant-appellee Lev M. Dawson.

OPINION

B. FLETCHER, Circuit Judge:

Plaintiffs, a class of persons who purchased stock in Valence Technology, Inc. (Valence) within a specified 27-month period, sued Valence and several of its officers for securities fraud in violation of section 10(b) of the Securities and Exchange Act of 1934. The district court granted Valence's motion for summary judgment, holding that Plaintiffs' claims were barred by the statute of limitations

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*The Honorable Myron H. Bright, Senior United States Circuit Judge for the Eighth Circuit, sitting by designation.

because Plaintiffs were on "inquiry notice" of the possibility of fraud more than one year before they filed suit. On appeal, Plaintiffs argue that "actual discovery," not inquiry notice, triggers the statute of limitations for claims under section 10(b). Alternatively, Plaintiffs contend the district court erred in holding that an article in the March, 1993 issue of *Forbes* magazine sufficed to put them on inquiry notice. Plaintiffs also appeal from the district court's earlier dismissal under Rule 12(b)(6) of claims against Valence's former CEO Lev Dawson for alleged fraud occurring after Dawson's resignation as CEO. We have jurisdiction pursuant to 28 U.S.C. § 1291. We reverse the district court's grant of summary judgment on the statute of limitations issue, and affirm its dismissal of the claims against Dawson.

I.

Plaintiffs brought this case as a securities class action on behalf of all persons who purchased stock in Valence between May 7, 1992 and August 10, 1994. Defendants include Valence, Lev Dawson (Valence's founder and first CEO), Calvin Reed (Valence's CEO between 1993 and 1997), Dale Shackle (a scientist and former Valence officer), and Carl Berg (a member of Valence's Board of Directors).[1] Plaintiffs allege that Valence violated section 10(b) of the Securities and Exchange Act of 1934 (the 1934

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[1] Except when distinguishing among the individual defendants, we use "Valence" to refer to all defendants collectively.

Act), *see* 15 U.S.C. § 78j(b), and Rule 10b-5 promulgated thereunder, *see* 17 C.F.R. § 240.10b-5.[2]

Valence was founded in 1989 to develop new battery technology. In May, 1992, after announcing that it was developing a new solid electrolyte rechargeable battery, Valence raised $33 million in an initial public offering of its stock. Valence stated that "[u]nlike the liquid electrolyte used in most batteries, the Company's electrolyte is a solid, which reduces weight, volume and safety problems." Valence also claimed that its solid electrolyte batteries were much more powerful for their size, having an "energy density" "significantly exceeding that of batteries currently in use." Moreover, Valence advertised its batteries as having an extended life cycle, with the capacity to be recharged many more times than conventional rechargeable batteries. Valence announced that it was focusing in particular on applying this technology to the commercial manufacture of batteries for use in cellular telephones and laptop computers. In November, 1992, Valence raised $82.8 million in a second public offering. In December, 1992, Valence announced the conclusion of a $100 million contract with Motorola, which was to begin using Valence's batteries in its cellular telephones in 1994.

On February 15, 1993, the March issue of *Forbes* magazine published an article about Valence entitled "Story

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[2] Plaintiffs further allege that Dawson, Reed, and Berg violated section 20(a) of the 1934 Act, *see* 15 U.S.C. § 78t(a). That section provides for joint and several liability for persons controlling persons or entities liable elsewhere under the 1934 Act.

Stock." Although press coverage of Valence had been quite positive up until then, the *Forbes* article was more skeptical. The headline of the article asked: "What levitates technology companies on Wall Street? Look at the case of Valence Technology and the curious merry-go-round of insiders, underwriters and journalists that keeps its stock spinning." The article claimed that while "the folks at Valence can put on a good show" in demonstrating prototypes of their battery, the investment community remained largely ignorant to "what is really energizing this stock":

> [A] triad that includes insiders unloading shares for a price hundreds of times what they paid, an underwriting firm that pulls in fees for helping them do that, and journalists who are only too willing to take at face value the boastful pronouncements of the company's publicity department.

Thus, although Valence's battery "works beautifully in the lab," "[t]he world doesn't know" whether it will "last" or if it can be "made cheaply."

The article took particular aim at Carl Berg, Valence's largest shareholder. It noted his participation in two other Silicon Valley enterprises through which he made large profits even though the companies themselves suffered financially. "The pattern," according to the article, "seems to be [that] . . . [o]utside investors may do poorly, but Berg usually gets his money out."

Valence and its officers made several public pronouncements in response to the *Forbes* article. Lev Dawson, then the CEO of Valence, sent a letter to *Forbes* that Valence distributed to shareholders, describing the article

as "inaccurate." Dawson maintained that Valence's contract with Motorola was a "basic purchase agreement" and not "less than meets the eye" as the *Forbes* article claimed. Dawson further noted that General Motors' Delco-Remy division "researched our technology prior to entering into a $20 million research and development contract for the development of batteries."

There was a modest press follow-up to the *Forbes* article. The *San Francisco Chronicle* published a story on February 27, 1993, reiterating the *Forbes* article's claim that "there was no reliable evidence that the batteries will work as advertised." *Bloomberg Business News*, in contrast, reported Dawson's response to the *Forbes* article in a February 17, 1993 wire story entitled "Valence Chairman Calls *Forbes* Article 'Inaccurate'." Later press coverage resumed its largely positive tone: September, 1993 stories in *Dow Jones Wire Service* and *The Wall Street Journal* reported Valence's announcement that it would deliver the batteries for the Motorola contract in the coming year. Neither story mentioned the *Forbes* article.

The week after the *Forbes* article was released, Valence's stock dropped from about $15.00 per share to $12.50 per share on February 23, 1993. It rose back to $15.00 on February 25, however. After fluctuating between $17.75 and $11.50 from early March into September, by September 28 the stock reached $20.00. In December, 1993, Valence completed its third public offering, raising $51.5 million.

On May 3, 1994, Valence announced that it was unable to meet Motorola's specifications, and that it would not be delivering batteries under that contract as

planned. On that day, Valence's stock dropped from $9.50 to $5.25. On June 16, 1994, Valence announced that it could not meet Hewlett-Packard's specifications. Valence's stock dropped from $6 to $3.813 on that day. On August 9, 1994, Valence announced that it was abandoning its new battery technology. Valence's stock then dropped from $4.375 to $3.375.

Plaintiffs filed suit on May 3, 1994. After consolidating subsequent complaints and certifying the class, the district court dismissed several of Plaintiffs' claims on Rule 12(b)(6) motions from Valence. In particular, the district court dismissed claims against Dawson relating to alleged misrepresentations made after he stepped down as CEO of Valence on April 30, 1993. Valence subsequently moved for summary judgment. The Special Master to whom the district court had referred the motion recommended granting summary judgment on statute of limitations grounds. The district court adopted that recommendation on November 6, 1997. *See In re Valence Tech., Inc. Sec. Litig.*, 987 F.Supp. 796 (N.D. Cal. 1997). This appeal timely followed.

II.

In granting Valence's motion for summary judgment on statute of limitations grounds, the district court held that for actions under section 10(b) of the 1934 Act, the statute of limitations begins to run with the disclosure of "facts that would have caused a reasonable person to suspect the possibility of a misrepresentation or misleading omission." *See In re Valence*, 987 F.Supp. at 801 (quoting *LaSalle v. Medco Research, Inc.*, 54 F.3d 443, 444 (7th

Cir. 1995)). This standard is a version of "inquiry notice." Plaintiffs contend that the correct standard is one of actual discovery.

We review a district court's grant of summary judgment de novo. *See Margolis v. Ryan*, 140 F.3d 850, 852 (9th Cir. 1998). Viewing the evidence in the light most favorable to the nonmoving party and drawing all reasonable inferences in its favor, we ask (1) whether the district court correctly applied the relevant law, and (2) whether there are any genuine issues of material fact. *See id.*

Private causes of action under section 10(b) of the 1934 Act and Rule 10b-5 promulgated thereunder are of judicial creation. *See, e.g., Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 730 (1975). Consequently, such actions have no statutorily-specified limitations period. However, in *Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson*, 501 U.S. 350 (1991), the Supreme Court held that the standard contained in section 9(e) of the 1934 Act applies also to actions under section 10(b). Thus, "[l]itigation instituted pursuant to § 10(b) and Rule 10b-5 must be commenced within one year after the discovery of the facts constituting the violation and within three years after such violation." *Id.* at 364.[3]

Plaintiffs contend that *Lampf* established an actual discovery standard for triggering the statute of limitations. *Lampf* does appear unequivocal on this point: "The

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[3] Section 9(e) provides, in pertinent part: "No action shall be maintained to enforce any liability created under this section, unless brought within one year after the discovery of the facts constituting the violation and within three years after such violation." 15 U.S.C. § 78i(e).

1-year period, by its terms, begins after *discovery* of the facts constituting the violation." 501 U.S. at 363 (emphasis added).[4] Moreover, in applying section 9(e)'s limitations period to actions under section 10(b), *Lampf* explicitly chose a provision requiring actual discovery over other provisions allowing inquiry notice. In contrast to section 9(e), section 13 of the Securities and Exchange Act of 1933 (the 1933 Act) stipulates that actions under that Act must be brought "within one year after the discovery of the untrue statement or the omission, *or after such discovery should have been made by the exercise of reasonable diligence.*" 15 U.S.C. § 77m (emphasis added). The Supreme Court in *Lampf* acknowledged the difference, and was clear about its choice: "[T]he various 1-and-3-year periods contained in the 1934 and 1933 Acts differ slightly in terminology. To the extent that these distinctions in the future might prove significant, we select as the governing standard for an action under § 10(b) the language of § 9(e) of the 1934 Act." 501 U.S. at 364.

We have not previously identified the correct standard in light of *Lampf*.[5] However, every circuit to have

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[4] An actual discovery standard does not require determining precisely when each plaintiff actually knew of facts sufficient to make out a claim of fraud. Courts can impute knowledge of public information without inquiring into when, or whether, individual shareholders actually knew of the information in question. *See Whirlpool Fin. Corp. v. GN Holdings, Inc.*, 67 F.3d 605, 610 (7th Cir. 1995) ("A reasonable investor is presumed to have information available in the public domain, and therefore . . . is imputed with constructive knowledge of this information.").

[5] Valence claims otherwise, citing *In re Stac Elec. Sec. Litig.*, 89 F.3d 1399 (9th Cir. 1996), *cert. denied sub nom. Anderson v.*

addressed the issue since *Lampf* has held that inquiry notice is the appropriate standard. *See, e.g., Sterlin v. Biomune Sys.*, 154 F.3d 1191, 1201 (10th Cir. 1998); *Great Rivers Co-op of S.E. Iowa v. Farmland Indus., Inc.*, 120 F.3d 893, 896-97 (8th Cir. 1997); *Ockerman v. May Zima & Co.*, 27 F.3d 1151, 1155 (6th Cir. 1994); *Tregenza v. Great American Comm. Co.*, 12 F.3d 717, 718 (7th Cir. 1993); *Menowitz v. Brown*, 991 F.2d 36, 41-42 (2d Cir. 1993); *Howard v. Haddad*, 962 F.2d 328, 329-30 (4th Cir. 1992); *Topalian v. Ehrman*, 954 F.2d 1125, 1134-35 (5th Cir. 1992). On a literal reading of *Lampf*, those decisions appear to be "contrary to the specific guidance issued by the Court." *Slavin v. Morgan Stanley & Co.*, 791 F.Supp. 327 (D. Mass. 1992); *see generally* Lewis D. Lowenfels & Alan R. Bromberg, *SEC Rule 10b-5*

Clow, 520 U.S. 1103, 117 S. Ct. 1105 (1997). *Stac* applied *Lampf* to a case involving section 10(b) claims and affirmed the dismissal of several defendants added to a suit over one year after it was first filed. *Stac* held that the statute of limitations began running with the original filing, because "plaintiffs were clearly aware of or suspected fraud at the time they filed their first complaint." 89 F.3d at 1411. In that case, therefore, the event triggering the statute of limitations was plaintiffs' filing of their complaint alleging specific acts of fraud. That filing would have sufficed under either an inquiry notice or an actual discovery standard. *Stac* did not specifically address which of the two standards applied. In fact, the *Stac* panel withdrew its original opinion in order to delete a passage stating that inquiry notice applies to actions under section 10(b). *See In re Stac Elec. Sec. Litig.*, 82 F.3d 1480, 1492 (9th Cir.), *amended by* 89 F.3d 1399 (9th Cir. 1996). Thus, *Stac* did not hold that inquiry notice is the standard. *See City Nominees Ltd. v. Macromedia, Inc.*, 1998 WL 267964, * 1 (N.D.Cal. May 18, 1998) (noting that *Stac* "implies that inquiry notice should be used," but recognizing that "[t]here is no Ninth Circuit case on point.").

and Its New Statute of Limitations: The Circuits Defy the Supreme Court, 51 BUS. LAW. 309 (1996).[6]

If we were to adopt inquiry notice, we would agree with the Tenth Circuit's formulation of that standard. In *Sterlin*, the Tenth Circuit surveyed case law from other circuits and found that most circuits "generally apply an inquiry notice standard coupled with some form of reasonable diligence requirement." *Id.* at 1199-1200. In *Sterlin*'s formulation, "inquiry notice . . . triggers an investor's duty to exercise reasonable diligence and . . . the one-year statute of limitations period begins to run once the investor, in the exercise of reasonable diligence, should have discovered the facts underlying the alleged fraud." 154 F.3d at 1201. Were we to apply the *Sterlin* test to this case, we would face two questions.

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[6] Several circuits, most notably the seventh circuit in *Tregenza*, seem to justify inquiry notice on policy grounds. *See Tregenza*, 12 F.3d at 722. To the extent policy considerations are relevant here, however, it is far from clear that inquiry notice is the more desirable standard. First, inquiry notice is not amenable to bright line rules. What information raises sufficient "red flags" to put shareholders on inquiry notice is, as the author of *Tregenza* has apparently recognized, not answerable as a per se matter. *See Fujisawa Pharm. Co., Ltd. v. Kapoor*, 115 F.3d 1332, 1334-37 (7th Cir. 1997) (Posner, C.J.). Second, adopting inquiry notice risks causing considerable confusion among shareholders. Indeed, triggering the statute of limitations on inquiry notice may force shareholders to choose between "risking what may be a frivolous suit filed timely on skimpy facts, and spending time investigating further on the chance that the short fuse may be running and later bar a legitimate action." Charles Benjamin Nutley, *Triggering One-Year Limitations on Section 10(b) and Rule 10b-5 Actions: Actual or Inquiry Discovery?* 30 SAN DIEGO L. REV. 917, 948 (1993).

First, did the *Forbes* article raise sufficient suspicion of fraud to cause a reasonable investor to investigate the matter further? Second, when should a reasonably diligent investor have discovered the facts underlying the alleged fraudulent activity? If the answer to the first question were yes, the answer to the second question would determine when the statute of limitations began to run.

In this case, we need not decide whether actual discovery or inquiry notice applies, because under either standard the *Forbes* article did not trigger the statute of limitations.[7] First, we note that the *Forbes* article made no allegation of actual fraud on the part of Valence or its principals. While an investor need not have full knowledge of fraud in order reasonably to be expected to investigate worrisome allegations concerning his investments, he will not be presumed to have done so unless the allegations are sufficient to "excite inquiry" into the possibility of fraudulent conduct. *Sterlin*, 154 F.3d at 1203 (quoting *Cook v. Avien*, 573 F.2d 685, 697 n. 25 (1st Cir. 1978)); *see Beneficial Standard Life Ins. Co. v. Madariaga*, 851 F.2d 271, 275 (9th Cir. 1988) (allegations must be substantial enough to "warrant inquiry"). A press article's general skepticism about a company's future prospects is not sufficient to excite inquiry into the specific possibility of fraud. Rather, in order for a press article to put shareholders on inquiry notice, there must be some reasonable nexus between the allegations made in the article and the

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[7] It is undisputed that if actual discovery is the appropriate standard, the *Forbes* article did not trigger the statute of limitations.

nature of the action subsequently brought. *See* 15 U.S.C. § 78i(e) (statute of limitations is triggered with "discovery of the *facts constituting the violation*") (emphasis added); *Gray v. First Winthrop Corp.*, 82 F.3d 877, 881 (9th Cir. 1996) ("The limitations period commences when the plaintiff 'has actual or inquiry notice that a *fraudulent misrepresentation* has been made.' ") (quoting *Volk v. D.A. Davidson & Co.*, 816 F.2d 1406, 1412 (9th Cir. 1987)) (emphasis added). In the context of section 10(b) actions, shareholders are on inquiry when they learn that a representation made by the company is "false for reasons likely to have been within the knowledge of the company when making it." *Law v. Medco Research*, 113 F.3d 781, 785 (7th Cir. 1997).

In this case, the *Forbes* article essentially raised questions about the ultimate viability of Valence's product, questions that even the article claimed were largely unanswerable. "Valence Technology's lithium/polymer battery works beautifully in the lab," the article noted, "But will it last? Can it be made cheaply? *The world doesn't know.*" (emphasis added). The article's conclusion that "investors ought to be a little choosier" before buying stock in Valence suggested simply that Valence's technology remained unproven. While perhaps warranting caution before investing, such a suggestion certainly does not excite inquiry into the possibility of fraud. Indeed, the article's most provocative claim – that a "curious merry-go-round of insiders, underwriters and journalists . . . keeps [Valence's] stock spinning" – challenged the enthusiasm and hype heaped on the product by the

industry, not the honesty or good faith of Valence's leaders.[8]

The negligible impact of the *Forbes* article bolsters our conclusion. First, the market exhibited little reaction to the article. Although Valence's stock did dip from $15.00 to $12.50 about ten days after the article was published, two days later it rebounded to $15.00. Six months later, the stock reached $20.00. Two months after that, Valence raised over $50 million in a third public offering. Since the market did not react adversely to the *Forbes* article, a reasonable investor can hardly be expected to have suspected fraud. *Compare Law*, 113 F.3d at 784 (noting that the market did not respond to a series of skeptical articles, and concluding that the articles did not put shareholders on inquiry notice), *with Sterlin*, 154 F.3d at 1204 (noting that stock price "suffered a slide" after publication of skeptical *Barron's* article putting

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[8] In this respect, the *Forbes* article stands in stark contrast to the *Barron's* article in *Sterlin*, 154 F.3d at 1202-04. The *Barron's* article implied that the company at issue, Biomune, had lied in its SEC filings. According to the *Barron's* article, Biomune claimed in its SEC filings that Jack Solomon, an investor who had previously faced SEC charges, owned no Biomune stock. The article pointed out, however, that a "byzantine array of entities in one way or another affiliated with Solomon own more than 35% [Biomune's] stock." *Id.* at 1203. The article thus alleged facts sufficient for a reasonable investor to conclude that Biomune had attempted to hide Solomon's interest in the company in order to survive SEC scrutiny. The *Forbes* article in this case contained no such allegations. While the article noted the checkered past of Carl Berg, one of Valence's principal investors, it did not state any facts from which it could be inferred that Valence was trying to mislead market regulators or defraud investors by hiding Berg's involvement in the company.

investors on inquiry notice). Second, other press coverage of Valence remained largely positive. Indeed, in September, 1993, both *Dow Jones Wire Service* and *The Wall Street Journal* ran positive stories on Valence without even mentioning the *Forbes* article. Third, Lev Dawson responded publicly to the article immediately after it was published, refuting its allegations and claiming that Valence was everything it purported to be. It is true that a "dear shareholder" letter alone is insufficient to dissipate "storm clouds" over a company once they have gathered. *See Sterlin*, 154 F.3d at 1204; *Great Rivers Coop.*, 120 F.3d at 898. But given the lack of any notable adverse market reaction or negative press follow-up, it would have been reasonable for a shareholder to read Dawson's letter and to conclude that nothing was amiss.

We hold, therefore, that the *Forbes* article would not have led a reasonable investor to investigate the possibility of fraud. Accordingly, regardless of whether we adopt actual discovery or inquiry notice as the governing standard, we find that the statute of limitations had not run when Plaintiffs filed their suit.[9]

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[9] If we adopted inquiry notice and found that the *Forbes* article did raise sufficient suspicions to cause a reasonable investor to investigate further, we would then have to remand the case to the district court to determine when, if ever, a reasonably diligent investor should have discovered the facts underlying the alleged fraud. *See Sterlin*, 154 F.3d at 1205.

III.

Over sixteen months before it granted Valence's motion for summary judgment, the district court dismissed all claims against Dawson "to the extent that they are based on alleged misstatements after April 30, 1993." The district court dismissed those claims for failure to state a claim upon which relief can be granted, *see* FED. R. CIV. P. 12(b)(6), stemming from failure to satisfy the requirements of "group pleading," *see* FED. R. CIV. P. 9(b), as set out in *In re GlenFed Sec. Litig.*, 60 F.3d 591, 593 (9th Cir. 1995). Plaintiffs contend that the dismissal was error.

We review de novo dismissals for failure to state a claim. *See Steckman v. Hart Brewing, Inc.*, 143 F.3d 1293, 1295 (9th Cir. 1998). In so doing, we treat the allegations in the complaint as true and draw all reasonable inferences in the plaintiff's favor. *See Warshaw v. Xoma Corp.*, 74 F.3d 955, 957 (9th Cir. 1996).

Rule 9(b) of the Federal Rules of Civil Procedure provides that "[i]n all averments of fraud . . . , the circumstances constituting fraud . . . shall be stated with particularity." In *GlenFed*, this court noted that in securities fraud cases, "[a] plaintiff may satisfy FED. R. CIV. P. 9(b) through reliance upon a presumption that the allegedly false and misleading 'group published information' complained of is the collective action of officers and directors." 60 F.3d at 593. *GlenFed* also held, however, that in order to rely on the "group published information" presumption, "Plaintiffs' complaint must contain allegations that an outside director either participated in the

day-to-day corporate activities, or had a special relationship with the corporation, such as participation in preparing or communicating group information at particular times." *Id.* Failure to allege such participation or position constitutes a failure to link the individual in question to the claims against the defendant corporation.

Dawson resigned as Valence's CEO on April 30, 1993. The district court held that since Plaintiffs failed to specify the nature of Dawson's operational involvement in Valence after that date, they were not entitled to the "group published information" presumption. Plaintiffs did allege in their Third Amended Complaint that Dawson remained Chairman of the Board until October 30, 1993. They also alleged that Dawson retained significant holdings in Valence after his resignation as CEO, and that he sold more than $30 million in stock in the months following. Plaintiffs did not, however, allege that Dawson had any operational involvement in Valence's day-to-day corporate activities. In fact, the Third Amended Complaint contains no allegations of how Dawson controlled or otherwise significantly influenced the alleged misstatements made by Valence after his resignation. Thus, the district court properly dismissed the claims against Dawson to the extent they are based on alleged misstatements made after his resignation.[10]

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[10] Plaintiffs cite *United States v. O'Hagan*, 521 U.S. 642, 117 S. Ct. 2199 (1997), to the contrary. *O'Hagan* recognized the "misappropriation theory" as a basis for liability under section 10(b) of the 1934 Act. Under that theory, "a person commits fraud 'in connection with' a securities transaction . . . when he misappropriates confidential information for securities trading purposes, in breach of a duty owed to the source of the

IV.

Because the *Forbes* article was insufficient to induce a reasonable investor to investigate the possibility of fraud, we hold that the district court erred in dismissing Plaintiffs' suit on statute of limitations grounds. In so holding, we do not decide whether actual discovery or inquiry notice triggers the statute of limitations for section 10(b) actions. We affirm the district court's dismissal of the claims against Dawson that are based on alleged misstatements made after he resigned as CEO of Valence.

Accordingly, the decisions of the district court are AFFIRMED in part and REVERSED in part, and the case is REMANDED to the district court for proceedings consistent with this opinion.

Appellants are entitled to their costs against appellees except Dawson.

Appellee Dawson is entitled to his costs against appellants.

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information." *Id.* at 2207. Plaintiffs allege that under this theory, Dawson can be held liable for injury caused by fraudulent statements made by Valence after his resignation as CEO. Not so. *O'Hagan* does confirm that Dawson is liable for "misappropriation" to the extent the profits he realized from stock sales after his resignation derived from fraud he committed before resigning, but the district court's dismissal did not relate to such liability. The district court merely held that in the absence of specific allegations of how Dawson continued to control the company, he cannot be held liable for damage caused by misstatements made by Valence after his resignation as CEO.

UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF CALIFORNIA
SAN JOSE DIVISION

IN RE VALENCE TECHNOLOGY, INC. SECURITIES LITIGATION	NO. C-95-20459-JW
This Document Relates To: ALL ACTIONS	JUDGMENT (Filed Nov. 6, 1997)

Based upon the Court's Order Granting Defendants' Motion for Summary Judgment, the Court enters judgment in favor of Defendants and against Plaintiffs.

IT IS SO ORDERED.

DATED: November 5, 1997

/s/ James Ware
JAMES WARE
United States District Judge

This is to certify that copies of this order have been mailed to:

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CLERK OF COURT

By: /s/ Ronald L. Davis
Ronald L. Davis
Deputy Clerk

UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF CALIFORNIA
SAN JOSE DIVISION

IN RE VALENCE TECHNOLOGY, INC. SECURITIES LITIGATION	NO. C-95-20459-JW ORDER GRANTING DEFENDANTS' MOTION FOR SUMMARY JUDGMENT
This Document Relates To: ALL ACTIONS	

I. INTRODUCTION

(Filed Nov. 6, 1997)

This case concerns whether a magazine article about questionable business practices starts the running of the statute of limitations for a securities fraud action based on those same questionable business practices. On July 14, 1997, special Master Paul Valentine submitted a Recommendation to grant Defendants' motion for summary judgment on the grounds that Plaintiffs' securities fraud claims are barred by the applicable one-year statute of limitations. Plaintiffs' objections to the Special Master's Recommendation were heard by the Court on September 22, 1997. Patrick Coughlin appeared on behalf of Plaintiffs. Robert Feldman, Tower Snow, John Missing, and James Lico appeared on behalf of Defendants. Based upon all pleadings filed to date, as well as the comments of counsel at the hearing, and after *de novo* review, the Court GRANTS summary judgment in favor of the Defendants.

II. BACKGROUND

This is a securities class action suit brought on behalf of all persons who purchased the securities of Valence Technology, Inc. ("Valence" or the "Company") between May 7, 1992 and August 10, 1994. Plaintiffs allege violations of Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. §78j(b) and Rule 10b-5 promulgated thereunder, 17 C.F.R. §240.10b-5 against all Defendants and violations of Section 20(a) of the Securities Exchange Act of 1934 against individual Defendants Lev Dawson, Calvin Reed and Carl Berg.

Plaintiffs allege that Defendants made fraudulent misrepresentations concerning the status of the technology and risks attendant to the development of commercial rechargeable lithium polymer batteries for the telecommunication, computer and automotive industry in connection with the initial public offering of the Company in May, 1992, which raised about $33 million, and additional stock offerings on November, 1992 and December 1993, which raised an additional $125 million. Plaintiffs allege that Defendants knew at all times that commercial mass production and usage of the lithium polymer battery was an illusion and that Defendants defrauded investors so that they could obtain millions of dollars in profits through insider sales. For example, Defendant Dawson allegedly sold over two million shares of Valence common stock for proceeds in excess of $40 million. During the relevant time period, Valence stock traded as high as $25.00 per share, and as low as $3.25 per share.

The Special Master recommended that Defendants' motion for summary judgment be granted on the grounds that Plaintiffs' claims are barred by the applicable one-year statute of limitations. In brief, the Special Master reasoned that an article entitled "Story Stock" about Valence published on or about February 15, 1993 in *Forbes* magazine, a national business magazine, disclosed sufficient facts to put a reasonable investor on inquiry notice of possible fraud; that Plaintiffs first complaint was not filed until May 1994, more than one year after the *Forbes* article was published; and therefore Plaintiffs' claims are time barred. The article stated:

> Want to get on the tech stock bandwagon? Here's an exciting company for you: Valence Technology, a San Jose, Calif. outfit that is developing a rechargeable lithium/polymer battery. Valence's battery packs more energy per pound than the well-established nickel/cadmium alternative, and it costs much, much less to manufacture. So says an "independent" scientist who has evaluated the technology. Valence has landed a $100 million order from Motorola – so say new reports. And Valence, though now in the red, will be a thriving company, earning $3.25 a share in 1997. So says a stock analyst report.
>
> * * *
>
> And if you believe the story that goes with Valence, you probably don't know about these drawbacks: The Motorola contract is much less than meets the eye; the largest share holder in Valence has been involved in two other Silicon Valley startups that failed; and the outside scientist who evaluated the battery just took

Valence insiders' word for it in judging manufacturing costs and durability.

* * *

More important is that investors don't look behind the road show to what is really energizing this stock: a triad that includes insiders unloading shares for a price hundreds of times what they paid, an underwriting firm that pulls in fees for helping them do that, and journalists who are only too willing to take at face value the boastful pronouncement of the company's publicity department.

As an experiment, compare these three documents: a Montgomery securities buy recommendation on the stock from last May, the government-sanctioned prospectus that came out with a 4.6 million-share offering in November, and a Valence press release issued in December. It's sometimes difficult to tell the three documents apart.

The press release, for example, contains a scientific-looking diagram of the lithium/polymer battery, marred by an arithmetic error on the dimensions of the battery's layers. Now look at the bullish report from Montgomery analysts Thomas Lloyd-Butler and Peter McGratty. It contains the same diagram, complete with the same error. And then there's the authoritative prospectus — with the same diagram and the same error.

The Montgomery analysts say that Valence Technology is going to rake in precisely $536,050,000 in revenues in fiscal 1997. How do they know that? Well, the battery will sell like the dickens because it's much more compact and

cheaper to make than competing batteries. The manufacturing cost of the Valence battery is going to be only 7½ cents per watt-hour of energy capacity, says the Montgomery report, a tenth the figure for nickel/cadmium batteries, the current standard in computers, telephones and the like. The battery keeps a charge better than nicads, says the report, losing 0.5% of its juice per month, against 5% to 20% for the nicad.

And how do the analysts know all this? They got it from Digby Macdonald, a materials science professor at Penn State, described as an "independent consultant."

How does Macdonald know about the Valence battery's performance and cost? He spent a day watching Valence scientists record measurements. He didn't take away a sample for testing, so he had to take their word for long-term performance measures. The cost projections are also from inside Valence. Independent? Montgomery Securities paid Macdonald for his analysis, but he won't say how much.

* * *

What about the Motorola purchase order, which boosted the stock 4⅜ points when it was announced in December? Look closely. It's not the same as, say, a purchase order from GM for tires. Motorola merely agreed to buy batteries if Valence can make them cheaply and if the batteries work. If they don't work, Motorola isn't on the hook for a dime.

Is Montgomery Securities an independent source? Judge for yourself. Montgomery got the lion's share of $7 million in total underwriting

fees for two stock offerings, one last May at 8, and another in November at 18. It may also be earning substantial spreads or commissions for helping insiders dribble out small amounts of their holdings to the public under the Securities & Exchange Commission's Rule 144. Immediately after the November offering, 4.7 million additional insider shares were eligible for sale, subject to Montgomery Securities' permission.

Most of the proceeds from the two underwritings went into Valence's coffers. But the largest shareholder, Carl Berg, with originally 33% of the shares outstanding, unloaded 495,000 of them in November, shares he bought at a penny each. He didn't sell in the first offering, but the company used 56.2 million of the proceeds to repay Berg loans he made to Valence to get the company going.

The prospectus omits some interesting details on Berg, 55, a California real estate developer and high-tech investor. He was a director and significant shareholder in Aetrix, a closely held computer maker that went under in the mid-1980s. Berg was also an insider in International Memories, Inc., a hard-drive company. In that capacity he was accused of securities fraud in a lawsuit filed by Minnesota Mining & Manufacturing Co. in 1978, a case that was eventually settled. IMI shareholders wound up with stock in Corvus Systems; Berg became Corvus' largest shareholder and creditor. Corvus filed for Chapter 11 in 1988. Berg is now the largest shareholder in Integrated Device Technology, a semiconductor firm that lost money in its last fiscal year. It has paid Berg at

> least $20 million in real estate transactions over the past four years.
>
> The pattern seems to be this: Outside investors may do poorly, but Berg usually gets his money out. Says Berg, "I like big rewards and big risk. Probably no one else would have put their money in [Valence]."
>
> A case can be made that the technology stock rally of the past year still has a way to go (*see* p. 114). Maybe so, but investors ought to be a little choosier.

Special Master's Recommendation, Ex. 2. Following the publication of this article in February 1993, Valence's stock price fell approximately forty percent (40%).

The Special Master acknowledged that much of the inquiry notice of fraud can only be discerned from the tone of the entire article, which reeked with warning. However, the special Master also outlined several examples of how matters disclosed in "Story Stock" in February 1993 became the gravamen of Plaintiffs' complaint. *See* Recommendation, pp. 14-17.

Plaintiffs contend that the Special Master's conclusions about the article's notice effect as well as the bar standard — inquiry versus actual notice — are not based on applicable law or a complete review of available evidence, and accordingly should not be adopted.

III. STANDARDS

Summary judgment is proper "if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is

no genuine issue as to any material fact and that the moving party is entitled to judgment as a matter of law." Fed.R.Civ.P. 56(c). The purpose of summary judgment "is to isolate and dispose of factually unsupported claims or defenses." *Celotex v. Catrett*, 477 U.S. 317, 323-324 (1986).

The moving party "always bears the initial responsibility of informing the district court of the basis for its motion, and identifying those portions of 'the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any' which it believes demonstrate the absence of a genuine issue of material fact." *Id.* at 323. If he meets this burden, the moving party is then entitled to judgment as a matter of law when the non-moving party fails to make a sufficient showing on an essential element of his case with respect to which he bears the burden of proof at trial. *Id.* at 322-23.

The non-moving party "must set forth specific facts showing that there is a genuine issue for trial." Fed. R. Civ. P. 56(e). The non-moving party cannot defeat the moving party's properly supported motion for summary judgment simply by alleging some factual dispute between the parties. To preclude the entry of summary judgment, the non-moving party must bring forth material facts, i.e., "facts that might affect the outcome of the suit under the governing law . . . Factual disputes that are irrelevant or unnecessary will not be counted." *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 247-48 (1986). The opposing party "must do more than simply show that there is some metaphysical doubt as to the material facts." *Matsushita Elec. Indus. Co. v. Zenith Radio*, 475 U.S. 574, 588 (1986).

The court must "draw all reasonable inferences in favor of the non-moving party, including questions of credibility and of the weight to be accorded particular evidence." *Masson v. New Yorker Magazine, Inc.*, 501 U.S. 496, 518-22, 111 S.Ct. 2419, 2434-35 (1991) (citing *Anderson*, 477 U.S. at 255); *Matsushita Elec. Indus. Co. v. Zenith Radio*, 475 U.S. 574, 588 (1986); *T.W. Elec. Service v. Pacific Elec. Contractors*, 809 F.2d 626, 630 (9th Cir. 1987). It is the court's responsibility "to determine whether the 'specific facts' set forth by the nonmoving party, coupled with undisputed background or contextual facts, are such that a rational or reasonable jury might return a verdict in its favor based on that evidence." *T.W. Elec. Service*, 809 F.2d at 631. "[S]ummary judgment will not lie if the dispute about a material fact is 'genuine,' that is if the evidence is such that a reasonable jury could return a verdict for the nonmoving party." *Anderson*, 477 U.S. at 248. However, "[w]here the record taken as a whole could not lead a rational trier of fact to find for the non-moving party, there is no 'genuine issue for trial.' " *Matsushita*, 475 U.S. at 587.

The Court reviews a Special master's findings and conclusion *de novo*. *See* Federal Rule of Civil Procedure 53(e)(2); *Estate of Conners by Meredith v. O'Connor*, 6 F.3d 656, 659 (9th Cir. 1993). The Court must enter its own order based on such review. *Id.*

IV. DISCUSSION

There are no disputed material facts. Plaintiffs contend that summary judgment based upon the statute of limitations should be denied because the inquiry notice

standard is inapplicable as a matter of law, and because the *Forbes* article did not place Plaintiffs on either inquiry or actual notice of Defendants' alleged fraud.

A. Inquiry Notice v. Actual Notice

Litigation under Rule 10b-5 "must be commenced within one year after the discovery of the facts constituting the violation." *Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson*, 501 U.S. 350, 364 (1991). The parties dispute whether the *Lampf* decision requires "actual" or "inquiry" notice to trigger the statute of limitations with respect to securities fraud actions. The Ninth Circuit has not yet squarely addressed this issue. However, there is at least one Ninth Circuit opinion which suggests that inquiry notice continues to apply after the *Lampf* decision. *See In re Stac Electronics Securities Litigation*, 89 F.3d 1399 (9th Cir. 1996).

Furthermore, it appears that every appellate court which has addressed the issue since the Supreme Court's ruling in *Lampf* has held that inquiry notice applies.[1] In the absence of controlling Ninth Circuit authority, this Court adopts the inquiry notice standard for the reasons

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[1] *Dodds v. Cigna Securities, Inc.*, 12 F.3d 346, 353 (2d Cir. 1993), *cert. denied*, 511 U.S. 1019 (1994); *Menowitz v. Brown*, 991 F.2d 36, 41-42 (2nd Cir. 1993); *Howard v. Haddad*, 962 F.2d 328, 330 (4th Cir. 1992); *Tregenza v. Great American Communications Co.*, 12 F.3d 717, 721-22 (7th Cir. 1993), *cert. denied*, 511 U.S. 1085 (1994); *LaSalle v. Medco Research, Inc.*, 54 F.3d 443, 444 (7th Cir. 1995); *Whirlpool Financial Corp. v. GN Holdings, Inc.*, 67 F.3d 605, 609 (7th Cir. 1995); *Olcott v. Delaware Flood Co.*, 76 F.3d 1538, 1549 (10th Cir. 1996).

offered in *Tregenza v. Great American Communications Company*, 12 F.3d 717, 721-22 (7th Cir. 1993), *cert. denied* 511 U.S. 1085 (1994).

Applying the inquiry notice standard, the statute of limitations for a 10b-5 claim begins to run when the plaintiffs have actual knowledge of the fraud *or* knowledge of facts sufficient to put a reasonable person on notice of fraud. *Davis v. Birr, Wilson & Co.*, 839 F.2d 1369, 1370 (9th Cir. 1988). "Notice" is provided by "facts that would have caused a reasonable person to suspect the possibility of a misrepresentation or misleading omission." *Lasalle v. Medco Research, Inc.*, 54 F.3d 443, 444 (7th Cir. 1995). It is not necessary for plaintiffs to have full knowledge of the existence of a claim or of each allegation in a claim. *Sterlin v. Biomune Systems, Inc.*, 960 F.Supp. 1531, 1535 (D. Utah 1997). Knowledge of facts that would lead a reasonable investor to exercise due diligence in investigating for potential fraud is sufficient. *Robuck v. Dean Witter & Co., Inc.*, 649 F.2d 641 (9th Cir. 1980); *Davis v. Birr, Wilson & Co.*, 839 F.2d at 1370. In other words, the statute of limitations is triggered once there are "sufficient storm warnings to alert a reasonable person to the possibility that there were either misleading statements or significant omissions involved in the sale." *Cook v. Avien, Inc.*, 573 F.2d 685, 697 (1st Cir. 1978). A reasonable investor is deemed to have knowledge of well publicized and widely available information in the public domain. *Whirlpool Financial Corp. v. GN Holdings, Inc.*, 67 F.3d 605, 610 (7th Cir. 1995); *Eckstein v. Balcor Film Investors*, 58 F.3d 1162 (7th Cir. 1995); *Cooke v. Manufactured Homes, Inc.*, 998 F.2d 1256, 1263 (4th Cir. 1993); *Sterlin*,

supra; In re Integrated Resources Real Estate Sec. Lit., 815 F.Supp. 620, 639 (S.D. N.Y. 1993).

The issue of inquiry notice is often a factual issue for a jury. However, where the underlying facts are undisputed, factually-based issues such as inquiry notice may be decided as a matter of law. *See Maggio v. Gerard Freezer & Ice Co.*, 824 F.2d 123, 128 (1st Cir. 1987); *Aizuss v. Commonwealth Equity Trust*, 847 F.Supp. 1482, 1486-87 (E.D. Cal. 1993). If it can be determined from the face of the parties' papers that plaintiffs were placed on inquiry notice of the possibility of fraud, and the plaintiffs failed to exercise reasonable diligence in discharging that duty to inquire, the court may impute constructive knowledge of the fraud to the plaintiffs. *Sterlin, supra.*

B. The Forbes Article

Plaintiffs contend that the *Forbes* article did not address the fraud or core allegations concerning Defendants' alleged misrepresentation of the Valence battery's nature, performance or safety characteristics, and therefore the article could not have placed the market on notice of fraud at Valence. As to the battery's nature, Plaintiffs assert that the article did not mention, much less question, one of the central bases for Plaintiff's suit, namely, whether Valence fraudulently misrepresented that its revolutionary new battery used a solid electrolyte instead of the conventional liquid electrolyte solution. Further, Plaintiffs assert that the article did not address the following additional core allegations concerning the battery's performance: that the Valence battery (1) operated four times longer on a single charge than a standard

nickel cadminium [sic] ("NiCad") battery of comparable weight, (2) had a total amount of available energy (energy density) of 205 Watt hours ("Wh")/kg and 383 Wh/1, allowing it to deliver equal power from a battery one-third the volume and one-quarter the weight of today's commonly used rechargeable batteries, and (3) was capable of over 150 deep discharge and 300 partial discharge cycles with no loss of capacity. In sum, Plaintiffs assert that while it is true that the *Forbes* article introduced some skepticism concerning Valence, it is not true the article put Plaintiffs or the market on notice of Defendants' fraudulent characterizations of the battery's electrolyte or its performance capabilities.

However, it is not necessary for Plaintiffs to have full knowledge of the scope of the fraud, the existence of a particular claim or of each allegation in a claim, to be on inquiry notice. *See, e.g. Dodds v. Cigna Securities, Inc.*, 12 F.3d 346 (2nd Cir. 1993); *Kennedy v. Josephthal & Company*, 814 F.2d 798, 802 (1st Cir. 1987); *Sterlin, supra*. Rather, the proper inquiry is whether the *Forbes* article imparted sufficient facts to put à reasonable person on notice of potential fraud. "The information that triggers inquiry notice of the probability of an alleged securities fraud is any financial, legal, or other data available to the plaintiffs providing them with sufficient storm warnings to alert a reasonable person to the probability that there were either misleading statements or significant omissions involved in the sale of securities." *Freedman v. Louisiana-Pacific Corp.*, 922 F.Supp. 377, 395 (D. Or. 1996), *quoting In re Integrated Resources Real Estate Sec. Litig.*, 815 F.Supp. 620, 639 (S.D. N.Y. 1993) (internal quotations omitted). Notice requires only the disclosure of sufficient

facts suggesting fraud to a reasonable investor. *In re General Development Corp. Bound Litig.*, 800 F.Supp. 1128, 1142 (S.D. N.Y. 1992).

In this case, the undisputed evidence leads to the inescapable conclusion that the *Forbes* article triggered inquiry notice. The title of the article — "Story Stock" — as well as its substance disclosed the general fraudulent scheme alleged by Plaintiffs in this case. that Defendants made misrepresentations about the Valence battery technology, driving up the stock price so that they could sell their shares at huge profits. The article opened by asking, "What levitates technology companies on Wall Street? Look at the case of Valence Technology and the curious merry-go-round of insiders, underwriters and journalists that keeps its stock spinning." The article also provided notice of scienter, suggesting that "Insiders," including one "accused of securities fraud" were "unloading shares for a price hundreds of times what they paid," while they were "energizing the stock" of "a company whose main asset is an unproven technology."

A comparison of the article and Plaintiffs' complaint further confirms that the market had long been aware of the facts that Plaintiffs contend were fraudulent. For example, the article disclosed that the scientist who evaluated the battery technology was not "independent" as Valence represented, but was paid by Montgomery. The article disclosed that the scientist spent only a day at Valence, that he did not conduct any independent tests, and just took Valence insiders' word regarding certain tests. In their complaint, Plaintiffs allege these very same facts as an indication of fraud.

The article disclosed that the Motorola contract was "much less than meets the eye." In their complaint, Plaintiffs allege that Mr. Dawson fraudulently stated that "the significance of the Motorola contract can't be overestimated." There are many other examples. Indeed, the facts disclosed and charges leveled by *Forbes* bear nearly a one-to-one correspondence to the allegations of Plaintiffs' original complaint.

Moreover, the *Forbes* article cast doubt on virtually all of Valence's representations about battery performance. The article highlighted the following representations as based upon unverified data from biased sources: (1) the battery is much more compact and cheaper to make than competing batteries; (2) the manufacturing cost of the Valence battery is gong to be only 7½ cents per watt-hour of energy capacity; and (3) the battery keeps a charge better than nicads, says the report, losing 0.5% of its juice per month, against 5% to 20% for the nicad. Thus, the *Forbes* article was sufficiently fact specific and comprehensive to put a reasonable person on notice of fraud.

C. Publications After the *Forbes* Article

Plaintiffs assert even if the *Forbes* article provided notice, the period of limitations should not run from the date of that publication because Defendant Dawson later wrote a letter disputing the substance of the *Forbes* article, and Valence's underwriter, Montgomery Securities, similarly criticized the article. Plaintiffs also cite to five other articles which they contend counteracted the skepticism

of the *Forbes* article. *See* Valence's Opposition, p. 6. Plaintiffs suggest that these articles so completely counteracted the *Forbes* article that Valence's stock value actually increased. Furthermore, Plaintiffs emphasize that even after the *Forbes* article, Valence conducted another successful public offering in December of 1993, which raised $51.5 million. Plaintiffs asserts that these positive market events are inconsistent with market notice of fraud. Plaintiffs also argue in the alternative, that even if the *Forbes* article triggered inquiry notice, the Plaintiffs' claims are not time barred to the extent they are based upon misrepresentations allegedly made after the *Forbes* article was published and within one year of the filing of the complaint, even if the alleged misrepresentations related to the same subject matter as the *Forbes* article. In particular, Plaintiffs contend that claims based upon misrepresentations allegedly made in connection with the December 1993 public offering are not time barred.

Plaintiffs' first argument, that subsequent optimistic publications counteracted the effect of the *Forbes* article and that market increases are inconsistent with fraud, is unavailing. Once the facts constituting inquiry notice are disclosed, "neither reassurances accompanying the relevant notice nor the continued failure to disclose the facts allegedly misrepresented in the first place, relieves the plaintiff of his duty to undertake reasonable inquiry or tolls the statute." *Lenz v. Associated Inns & Restaurants Co. of Am.*, 833 F.Supp. 362, 376, n. 12 (S.D.N.Y. 1993) *quoting In re Integrated Resources Real Estate Limited Partnerships Securities Litigation*, 815 F.Supp. 620, 640 (S.D. N.Y. 1993). Indeed, if anything, the conflicting information being put out into the market by *Forbes* and Defendant Dawson

should have heightened, not alleviated, a reasonable investor's suspicion of potential fraud.

The Court also rejects Plaintiffs' second argument, that the statute of limitations does not bar claims based upon misstatements allegedly made after the *Forbes* article was published and within one year of the filing of the complaint. The allegedly fraudulent scheme was disclosed by the *Forbes* article, even if the alleged scheme continued to be in operation. The logic of *Lenz, supra*, and *Integrated Resources, supra*, dictate that once the *Forbes* article triggered the duty to inquire into potential fraud, that duty was not extinguished by the passage of time or excused by subsequent alleged misstatements by Defendants regarding the same subject matter as the *Forbes* article. Instead, the duty of inquiry continued, and therefore barred any claims based upon the same fraudulent scheme described in the *Forbes* article. Stated differently, once the *Forbes* article alerted Plaintiffs of the possibility of fraud, Plaintiffs could not reasonably rely upon any further statements by the Defendants regarding commercial rechargeable lithium polymer batteries. Under these circumstances, the Court finds that all claims set forth in Plaintiffs' complaint are time barred.

V. CONCLUSION

For the reasons set forth above, the Court GRANTS Defendants' motion for summary judgment.

DATED: November 5, 1997

/s/ James Ware
JAMES WARE
United States District Judge

This is to certify that copies of this order have been mailed to:

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SPECIAL MASTER

UNITED STATES DISTRICT COURT

NORTHERN DISTRICT OF CALIFORNIA

IN RE VALENCE TECHNOLOGY SECURITIES LITIGATION This Document Relates To: ALL ACTIONS	Case No. C95-20459(JW)(EAI) RECOMMENDATION OF SPECIAL MASTER TO GRANT THE DEFENDANTS' MOTIONS FOR SUMMARY JUDGMENT BECAUSE ACTION IS BARRED BY STATUTE OF LIMITATIONS

Introduction

This is a securities class action brought on behalf of all persons who purchased the securities of Valence Technology, Incorporated ("Valence" or the "Company") between May 7, 1992 and August 10, 1994. Proceeding under its Fourth Consolidated Amended Class Action Complaint filed June 27, 1996, plaintiffs allege violations of Section 10(b) of the Securities and Exchange Act of 1934, 15 U.S.C. § 78j(b) and Rule 10b-5 promulgated by the Securities and Exchange Commission, 17. C.F.R.

§ 240.10b-5 against all defendants and violations of Section 20(a) of the Securities and Exchange Act of 1934 against individual defendants Lev Dawson, Calvin Reed and Carl Berg.

Defendants are the company, and individuals Lev Dawson, founder and former Chairman of the Board and Chief Executive Officer of Valence ("Dawson"); Calvin Reed, Chairman of the Board and Chief Executive Officer of Valence ("Reed"); Carl Berg, principal investor and outside member of the Board of Directors of Valence ("Berg"); and Dr. Dale Shackle, former Vice President and Chief Technical Officer of Valence ("Shackle").

Plaintiffs allege that defendants fraudulently misrepresented the status of the technology and risks attendant to the development of commercial rechargeable lithium polymer batteries for the telecommunication, computer and automotive industry in connection with the initial public offering of the Company in May, 1992, which raised about $33 million, and following-on offerings in November, 1992 (about $75 million) and December 1993 (about $50 million).

The Class Period begins May 7, 1992, the date of the IPO, and ends August 10, 1994, the date Valence announced abandonment of its efforts to develop commercial lithium polymer batteries.

This Court has ruled previously that the period of liability for defendant Dawson begins May 7, 1992 and

ends April 30, 1993, the date when he resigned from the Company[1].

Each defendant has filed a Motion for Summary Judgment which was referred to the Special Master Hearings have been held, and the Master is preparing Recommendations on those Motions, together with Rulings on several objections and motions to strike evidence submitted in support of respective arguments of plaintiffs and defendants with respect to the Motions for Summary Judgment.

This is a very complex case involving a mass of evidence. The Motions for Summary Judgment have required analysis of hundreds of exhibits, virtually all of which are contested, and thousands of pages of deposition excerpts.

This Recommendation concerning the statute of limitations has been broken out from analysis of the Motions for Summary Judgment and submitted independently for these reasons:

1) As shown below, applicability of the statute of limitations here is a question of law based on uncontroverted facts.

2) In a case of this complexity and girth, the threshold issue of the statute of limitations warrants the singular focus of the Court.

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[1] *Order . . . Granting Defendant Dawson's Motion to Dismiss Certain Claims . . .* February 13, 1996; *Corrected Order Granting . . . Dawson's Motions to Dismiss Plaintiffs' Section 20(a) Claims,* June 5, 1996.

3) The statute of limitations issue can be decided by the Court more efficiently when considered independently than as one of many issues in defendants' motions for summary judgment.

4) This case is set for trial in the 3rd Quarter 1997; the statute of limitation issue should be decided as soon as possible.

5) The Recommendations on defendants' Motions for Summary Judgment will not be submitted for several more weeks.

6) On April 2, 1997 the United States District Court for the District of Utah held in a Rule 10(b)5 case, on facts remarkably similar to the case at bar, that a single negative article about the defendants published in *Barron's* more than one year before the complaint was filed put plaintiffs on inquiry notice of fraud; that consequently plaintiffs claims were barred as matter of law by the statute of limitations and dismissed the complaint.[2]

Background[3]

Valence is engaged in the research, development and production of advanced lithium polymer rechargeable

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[2] *Sterlin v. Biomune Systems, Inc.* ___ F. Supp ___, 1997 WL 180858 (D. Utah), attached at Exhibit 1. The statute of limitations was briefed as an element of defendants' motions for summary judgment. Supplemental letter briefs were submitted as to the implication of the *Sterlin* case.

[3] This Overview is based on summaries of the case in prior Orders of this Court.

batteries for use in a variety of consumer electronic products, including cellular telephones, portable computers, and automobiles. Lev Dawson founded Valence in March 1989. In July 1990, the company acquired battery technology from the Mead Corporation for approximately $2 million. Valence began research and development of battery prototypes based on Mead's technology for the purpose of adapting lithium polymer battery technology to commercial lightweight, energy-efficient batteries.

Valence made its initial public offering ("IPO") in May 1992, and made additional stock offerings in November 1992 and December 1993. Valence was not able to create a commercially viable battery. When this information was released to the public on August 9, 1994 Valence's stock prices dropped dramatically.

The Complaint in this action was filed May 4, 1994. Plaintiffs allege that defendants, along with the underwriters, committed fraud on the market by misrepresenting to the investing public the true nature of the development and commercial viability of the lithium polymer battery. Plaintiffs claim that defendants knew at all times that commercial mass production and usage of the lithium polymer battery was an illusion and that they defrauded investors so that the defendants could obtain millions of dollars in profits through insider sales. Plaintiffs note that Valence stock, which at one point traded as high as $25 per share, ultimately dropped to $3.00 per share.

Plaintiffs allege that defendant Dawson was a Valence founder, Chief Executive Officer until he resigned April 30, 1993, and Chairman of the Board until defendant Calvin L. Reed took over that position on October

12, 1993. Plaintiffs allege Dawson sold over two million shares of Valence common stock for proceeds in excess of $40 million. Plaintiffs allege that because of his position with Valence, Dawson had access to adverse non-public information about Valence's finances, products, and business prospects from conversations with other corporate officers and employees, attendance at management Board of Directors' and committee meetings, as well as reports produced in connection with such meetings.

III. The Clash in Theory

This case is rooted in a clash in perception and theory about the funding of this Company. Plaintiffs' theory is that funding of Valence was a huge fraud. Plaintiffs believe that Dawson, who was not a scientist but self-educated about the need and potentially lucrative market for rechargeable batteries, and Berg invested heavily in the early stages of the company and acquired the Mead technology. Plaintiffs allege that Berg and Dawson discovered in early 1991 that the Mead technology was nearly worthless and learned of serious shortcomings in being able to manufacture lithium polymer batteries using Valence technology; that they then worked the scheme to continue to promote the failed technology to capture the investment public's imagination so that they could recoup some of their failed investment by selling Valence stock at inflated prices into the market after the IPO and the follow-on offerings[4].

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[4] *Fourth Consolidated and Amended Class Action Complaint,* ("FAC") §§ 37, 38.

Not surprisingly, defendants view is that plaintiffs' theory of the case is absurd; that Valence was founded on the promise of prototype lithium polymer technology which would have revolutionized consumer electronics with lighter, more powerful, durable, adaptable and safe rechargeable batteries had it been successful.

This litigation will decide whether this is the story of an innovative Silicon Valley start-up which suffered great technical setbacks, or the securities fraud plaintiffs assert.

IV. The Law

A. Summary Judgment

Rule 56(c), Fed. R. Civ. Proc. provide that a court may grant summary judgment "if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law." Under the Supreme Court's 1986 *Celotex* trilogy of cases[5], the parties seeking summary judgment, here, the defendants, must show an absence of a genuine issue of material fact. Once the defendants have made that showing, Rule 56(c), Fed. R. Civ. Proc. requires that the plaintiffs, as non-moving parties, designate specific facts showing that there is a genuine issue for trial. When the defendants have carried their burden under Rule 56(c), the plaintiffs

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[5] *Celotex Corp. v. Catrell*, 477 U.S. 317 (1986); *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242 (1986); *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574 (1986).

must do more than simply show that there is some metaphysical doubt as to material facts. If the evidence is merely colorable, or is not significantly probative, summary judgment may be granted[6]. When determining whether there is a genuine issue for trial, inferences to be drawn from the underlying facts . . . must be viewed in the light most favorable to the plaintiffs, as the parties opposing the motion[7].

B. Rule 10(b)-5

Rule 10(b)-5 of the Securities and Exchange Act of 1934 makes it unlawful to "make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstance under which they were made, not misleading."[8]

To withstand defendants' motions for summary judgment the plaintiffs have the burden of producing "significant probative evidence" as to each element of each of their securities fraud claims under Rule 10b-5: (1) a false or misleading statement of material fact; (2) scienter; (3) transaction and loss causation; and (4) damages.[9] To establish scienter, plaintiffs must prove either actual

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[6] *Liberty Lobby, 477 U.S. at 249-50.*

[7] *Matsushita,* 475 U.S. at 587.

[8] 17 C.F.R. § 240.10(b) (1996).

[9] *In re Apple Computer Sec. Litig.,* 886 F.2d 1109, 1113 (9th Cir. 1989), *cert. denied, sub nom, Schneider v. Apple Computer, Inc.,* 496 U.S. 943 (1990); *McGonigle v. Combs,* 968 F.2d 810, 821 (9th Cir.), *cert. Dismissed,* 506 U.S. 948 (1992).

intent to defraud, or recklessness, defined as "a highly unreasonable omission . . . not merely simple, or even inexcusable negligence, but an extreme departure from the standards of ordinary care."[10]

Litigation under Rule 10(b)-5 "must be commenced within one year after the discovery of the facts constituting the violation."[11] The statute of limitations begins to run when the plaintiff has knowledge of facts sufficient to put a reasonable person on notice.[12] Knowledge of the facts that would lead a reasonable investor to exercise due diligence in investigating for potential fraud is sufficient.[13] Once notice of such facts is given, the statute does not await a plaintiff's "leisurely discovery of the full details of the alleged scheme."[14] A reasonable is deemed to have knowledge of all information in the public domain.[15]

" . . . (T)he statutory period does not run when a plaintiff has full knowledge of the existence of a claim or of each allegation in a claim, but when notice of the possibility of a claim arises . . . notice of each allegedly

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[10] *Hollinger v. Titan Capital Corp.*, 914 F.2d 1564, 1569 (9th Cir. 1990) *(en banc), cert. Denied,* 199 U.S. 976 (1991).

[11] *Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson,* 501 U.S. 350, 364 (1991).

[12] *Davis v. Birr, Wilson & Co.,* 839 F.2d at 1370 (9th Cir. 1988).

[13] *Robuck v. Dean Witter & Co., Inc.* 649 F.2d 641 (9th Cir. 1980); *Davis,* 839 F.2d at 1370.

[14] *Cook v. Avien,* 573 F.2d 685, 696, (1st Cir. 1978) (internal quotation omitted).

[15] *Whirlpool Financial Corp. v. GN Holdings, Inc.* 67 F.3d 605, 610 (7th Cir. 1995).

illegal claim in the complaint (is not required). Inquiry notice does not exact such minutia. A plaintiff need not fully discover the full exposition of the fraudulent scam to be on inquiry notice."[16]

"Furthermore, awareness of a defendant's other lawsuit . . . puts a plaintiff on inquiry notice of the probability of fraud within the transaction involving the plaintiff."[17]

The "fraud on the market" theory is "based on the hypothesis that, in an open and developed securities market, the price of a company's stock is determined by the available material information regarding the company and its business (can) defraud purchasers of a stock even if the purchasers do not directly rely on the misstatements. . . . The causal connection between the defendants' fraud and the plaintiffs' purchase of stock in such a case is no less significant than in a case of direct reliance on misrepresentation."[18]

V. The Motion for Summary Judgment

A. Defendants Argument

Defendants argue that the scathing article "Story Stock"[19] about Valence published on or about February

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[16] *Sterlin* at 1997 WL 180858 *5(citations omitted).

[17] *Id.*

[18] *A&J Deutscher Family Fund v. Bullard, Pacific Scientific Co, Inc.* 1988 U.S. Dist. LEXIS 15806 *18 (C.D.C.A. 1988) quoting from *Peil v. Speisher*, 806 F.2d 1154, 1160-61 (3rd. Cir. 1986).

[19] Attached, Exhibit 2.

15, 1993 *Forbes* magazine, the national business magazine, disclosed many of the facts on which plaintiffs' complaint for fraud and misrepresentation under Rule 10(b)5 is based; that plaintiffs' first complaint was filed until May 4, 1994, more than one year after the *Forbes* article was published; that the theory of plaintiffs' case is that the fraud and misrepresentation perpetrated by defendants was a fraud on the market and that publication of the *Forbes* article disclosed to the market the underlying facts on which plaintiffs' complaint is based more than one year before the complaint was filed; hence, the case is time-barred by the one-year statute of limitations in Rule 10(b)5.

Defendants argue that the applicability of the statute of limitations is a question of law based on uncontroverted facts that the *Forbes* article "Story Stock" was published on or about February 15, 1993; that the "Story Stock" says what it says; and that plaintiffs have invoked the "fraud on the market" doctrine [thereby avoiding having to establish plaintiffs' actual reliance on the alleged fraud] claiming to rely on all the information about Valen.e in the market. In defendants' view whether the statute of limitations bars this action is a question of law which turns on the interpretation by this Court of "Story Stock" published by *Forbes* and plaintiffs' complaint.

Defendants argue that the recently-decided *Sterlin* case from the Tenth Circuit is consistent with well-settled statute of limitations law in the Ninth Circuit and is applicable to this case. In *Sterlin* the court granted motions to dismiss a Rule 10(b)5 case when a blistering article in *Barron's* about the Biomune Systems corporation

was published more than one year before the compliant [sic] was filed. Defendants also argue that the facts about Valence disclosed in the *Forbes* article gave the market even more facts and thus created even stronger suspicion of fraud than did the facts disclosed about Biomune Systems in *Barron's,* noting the remarkably similar content of the two articles:

Forbes on Valence	***Barron's on Biomune***
1. Valence is supposed to have a revolutionary new battery.	1. Biomune is supposed to have a revolutionary new drug.
2. "And if you believe the story that goes with Valence, you probably don't know about these drawbacks:"	2. "The story you are about to read is true . . . Maybe its retelling will protect a few innocents."
3. The Company's investment banker (Montgomery) predicts big earnings, even though the company does not have a marketable product.	3. The company's investment banker (Ladenburg, Thalmann & Co.) Predicts big earnings, even though the company does not have a marketable product.
4. Beware unfounded predictions of success from biased sources:	4. Beware predictions of success based on unreasonable assumptions from biased sources:

- Valence has an "unproven technology;"

- Biomune's drug has not even been tested on humans; others who have tested similar drug have had "equivocal" results;

- the much-touted $100 million Motorola contract is "much less than meets the eye," it is "merely" an option to buy batteries "if" Valence can build them;

- Biomune's assumed not only that its drug will work, but that the FDA would approve it in 18 months, when the average FDA approval takes over eight years.

- the ostensibly "independent" assessment of the technology relied on Valence data and was paid for by Valence's banker; the earnings estimates come from the same interested sources.

- the "optimistic" estimates of the company's success come from the company and its investment banker; others working on the same kind of drug put Biomune's chances at "one in 100."

5. A 33% shareholder has been involved in several "failed" Silicon Valley start-ups, was sued for securities fraud in connection with a company that is now bankrupt, and just "unloaded" 495,000 shares in Valence.	5. A *35% shareholder* has been involved in a string of "new age" ventures, and was charged by the SEC with illegally selling 8.7 million shares in a now worthless company.
6. "The pattern seems to be this: outside investors may do poorly, but Berg usually gets his money out."	6. "There's a lesson there somewhere"

B. Plaintiffs Opposition

Plaintiffs read the *Lampf* and *Gruber*[20] cases as establishing that the limitations period of Rule 10(b)5 does not start to run until "after the discovery of the facts constituting the violation".[21] Plaintiffs reject that the inquiry notice standard applies to the statute of limitations under Rule 10(b)5. Plaintiffs argue that even if there were an inquiry notice standard under Rule 10(b)(5) the "Story Stock" article in *Forbes* did not trigger the period because: 1) Dawson refuted the article in a widely-disseminated letter to investors; 2) in the opinion of plaintiffs expert

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[20] *Gruber v. Price Waterhouse*, 911 F.2d 960, 964 n.4 (3rd Cir. 1990).

[21] *Opposition* at 43.

Torkleson "Story Stock" did not reveal that defendants acted with scienter – an essential element of liability necessary to start the limitations period in the Ninth Circuit,[22]; and 3) even if the article did reveal fraud, that knowledge could not be imputed to members of the class who were under no duty to read the article.[23]

Plaintiffs argue that the *Sterlin* case from the District Court of Utah is not binding on this Court; that *Sterlin* is directly contrary to precedent in the Ninth Circuit; and that even if *Sterlin* were some sort of guiding authority the case would not warrant the conclusion as a matter of law that "Stock Story" in *Forbes* constituted "uncontroverted evidence [that] irrefutably demonstrates plaintiff discovered or should have discovered the fraudulent conduct"[24]; and finally that defendants' scheme to conceal the true state of Valence Technology extended for 17 months after publication of the *Forbes* article.

VI. Findings

A. The Special Master finds that the following facts are uncontroverted:

1. The article "Story Stock", Exhibit 1, was published by *Forbes* magazine on or about February 15, 1993.

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[22] Relying on *Nevada Power Co. v. Monsanto Corp.* 955 F.2d 1304, 1307-08 (9th Cir. 1992).

[23] Relying on *Briskin v. Ernst & Ernst*, 589 F.2d 1363, 1367-68 (9th Cir. 1978).

[24] *Gray v. First Winthrop Corp.*, 82 F.3d 877, 881 (9th Cir. 1996).

2. *Forbes* magazine is a business publication widely circulated throughout the business and financial community in the United States.

3. Plaintiffs' first Complaint in this action was filed May 4, 1994.

4. Analysis of the gravemen [sic] of plaintiffs' claims in this Recommendation is based on plaintiffs' *Fourth Consolidated and Amended Class Action Complaint for violation of the Federal Securities Laws* filed June 27, 1996.

B. The Special Master finds that no facts as to which there is a genuine dispute are relevant to this Motion; this Motion raises a question of law for the Court.

VII. Analysis and Discussion

Whether the publication of "Story Stock" disclosed sufficient facts to put a reasonable investor on inquiry notice is a question of law for this Court in interpreting the article and the plaintiffs' complaint. This issue has been framed as a motion for summary judgment by the parties. No material facts are in dispute, and the issue can be decided by this Court as a matter of law.[25]

Courts in the Ninth Circuit uniformly apply "inquiry notice" to Rule 10(b)5 claims[26]. Investors must bring their claims promptly after learning of such facts to warrant litigation [actual notice] or when sufficient facts are known as to put a reasonable person on notice [inquiry

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[25] *Volk v. Davidson*, 816 F.2d 1406 (9th Cir. 1987).

[26] See *e.g. Volk v. Davidson*, 816 F.2d 1406 (9th Cir. 1987).

notice].[27] Once the investor has sufficient facts as to put a reasonable person on inquiry notice that person cannot wait until the whole scheme is discovered or to see how the investment turns out to initiate litigation.[28]

After analyzing the *Barron's* article the *Sterlin* court concluded that sufficient facts had been disclosed by the article to have put those plaintiffs on inquiry notice of the possible fraud at Biomune Systems. Of course the *Sterlin* case is not binding on this Court. But *Sterlin* is entirely consistent with the law in the Ninth Circuit and sharply focuses and provides guidance on the issue here: whether in this "fraud on the market" case the injection of the "Story Stock" article into the market in February 1993 provided sufficient facts to put a reasonable investor on notice of possible fraud at Valence.

A comparison of the facts disclosed in the *Forbes* article with the trail of those facts into the complaint reveals that the *Forbes* article did inject sufficient facts into the market to put a reasonable investor on inquiry notice of possible fraud at Valence more than one year before the complaint was filed. Much of that inquiry notice of fraud can only be discerned from the tone of the entire article which reeks with warning, but there are there are several examples how matters disclosed in "Story Stock" in February 1993 became the gravamen plaintiffs' complaint in May 1994:

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[27] *Davis v. Birr, Wilson & Co.*, 839 F.2d at 1370. (9th Cir. 1988).

[28] *Cook v. Avien*, 573 F.2d 685, (1st Cir. 1978); *Volk* at 816 F.2d 1413.

Excerpts from "Story Stock" Published in March 1, 1993 *Forbes*

(Page 112, Col. 1)

1. *Forbes*

"WANT TO GET ON the tech stock bandwagon"? Here's an exciting company for you: Valence Technology, a San Jose, Calif. outfit is developing a rechargeable lithium/polyer battery. Valence's battery packs more energy per pound than the well-established nickel/cadmium alternative and it costs much, much less to manufacture. So says an "independent" scientist who has evaluated the technology. Valence has landed a $100 million order from Motorola – so say news reports. And Valence, though now in the red will be a thriving company, earning $3.25 a share in 1997. So says a stock analyst report. "If you believe all that, you must be one of the investors who have bid Valence stock up to outlandish levels . . .

And if you believe the story that goes with Valence, you probably don't know about these drawbacks; the Motorola contract is much less than meets the eye:

Complaint

Plaintiffs' allegations of false and misleading statements about the Motorola contract are in ¶¶ 68-71, attached, Exhibit 3.

2. *Forbes*

"The largest shareholder in Valence has been involved in two other Silicon Valley startups that failed; and the outside scientist who

evaluated the battery just took Valence insiders' word for it in judging manufacturing costs and durability."

Complaint

Plaintiffs allegations about the false and misleading statements about the "independent battery consultant" Dr. MacDonald appear in ¶ 57, attached, Exhibit 4.

(Page 112, Col. 3)

3. *Forbes*

" . . . (W)hat is really energizing this stock (is) a triad that includes insiders unloading shares for a price hundreds of times what they paid,

Complaint

Plaintiffs allegations about stock sales by Dawson appear in ¶ 20(a) and by Berg in ¶ 20(d)(v), attached, Exhibit 5.

4. *Forbes*

(Page 112, Col. 3)

" . . . and journalists who are only too willing to take at face value the boastful pronouncements of the company's publicity department.

"As an example compare these three documents: a Montgomery Securities buy recommendation on the stock from last May, the government sanctioned prospectus that came out with a 4.6 million share offering in November and a Valence press release, issued in December. It's sometimes difficult to tell the three documents apart.

"The press release, for example, contains a scientific-looking diagram of the lithium/polymer battery, marred by an arithmetic error . . . now look at the bullish report from Montgomery analysts Thomas Lloyd-Butler and Peter McCratty. It contains the same diagram with the same error.

Complaint

Plaintiffs allegations about the interrelationship between Valence and security analysts and about the typographical error appear in ¶¶ 52 and 53, attached, Exhibit 6.

5. *Forbes*

(Page 113, Col. 1)

"The Montgomery analysts say that Valence Technology is going to take imprecisely $536,050,000 in revenues in fiscal 1997. How do they know that? Well, the battery will sell like the dickens . . . manufacturing cost . . . is going to be only 7½ cents Iper watt-hour of energy capacity . . . the battery keeps a charge better than nicads . . .

"And how do the analysts know all this? . . . from Digby Macdonald, a materials science professor at Penn State, described as an "independent consultant".

"How does Macdonald know about the Valence battery's performance and cost? He spent a day watching Valence scientists record measurements. He didn't take away a sample for testing, so he had to take their word for long-term performance measures. The cost projections are also from inside Valence. Independent? Motgomery

[sic] paid Macdonald for his analysis, but he won't say how much."

Complaint

Plaintiffs' allegations about false and misleading statements in the reports of Montgomery and Dr. Macdonald appear in ¶¶ 57 and 58, attached, Exhibit 4.

6. *Forbes*

(Page 113, Col. 1, 2)

"If you don't put much stock in analysts reports, maybe you will be persuaded by the glossy reprints distributed by Valence and its public relations firm. They include an item from *Fortune's* 1993 Investors Guide, quoting Lloyd-Butler sales projections for 1997 and reciting as fact that Valence claims that its battery can be recharged 300 times and loses only 0.5% of its charge per month when left on a shelf."

Complaint

Plaintiffs' allegations about false and misleading statements in the *Fortune* article appear in ¶ 63, attached, Exhibit 8.

7. *Forbes*

(Page 113, Col. 2)

What about the Motorola purchase order, which boosted the stock 4 3/8 points when it was announced in December? Look closely. It's not the same as, say, a purchase order from GM for tires. Motorola merely agreed to buy batteries if Valence can made them cheaply and if the batteries work. If they don't work, Motorola isn't on the hook for a dime."

Complaint

Plaintiffs' allegations of false and misleading statements about the Motorola contract are in ¶¶ 68-71, attached, Exhibit 3.

8. *Forbes*

(Page 113, Col. 2, 3)

"Most of the proceeds from the two underwritings went into Valence's coffers, But the largest shareholder, Carl Berg, with originally 33% of the shares outstanding, unloaded 495,0000 [sic] of them in November, shares he bought at a penny each.

. . . Berg was also an insider in International Memories, Inc. a hard-drive company. In that capacity he was accused of fraud in a lawsuit filed by Minnesota Mining and Manufacturing Co in 1978, a case that was eventually settled . . . (where) IMI shareholders wound up with Corvus Systems; Berg became Corvus' largest shareholder and creditor.

The pattern seems to be this: Outside investors may do poorly, but Berg usually gets his money out. Says Berg: "I like big reward and big risk. Probably no one else would have put their money in (Valence)."

Complaint

Plaintiffs allegations about Mr. Berg's stock sales appear in ¶ 20(d) attached, Exhibit 5.

The significance of the above analysis is that the facts which formed the key elements of plaintiffs' complaint filed in May 1994 had been disclosed to the market in the

[sic] February, 1993. In relying on the "fraud-on-the-market" doctrine, plaintiffs claim reliance on all statements about Valence in the market. That doctrine does not permit the plaintiffs to rely on those statements in the market about Valence which are helpful to their case; *i.e.* Valence statements to the market about the technology which plaintiffs allege to be false and misleading, and reject other statements in the market which are not; *i.e.* those statements disclosing possible fraud at Valence injected into the market by *Forbes*. When plaintiffs filed their complaint in May 1994 the key facts on which they rely for a cause of action under Rule 10(b)5 had been been in the market more than one year. Those facts, highlighted above, are more than sufficient to put a reasonable investor on inquiry notice of the possibility of fraud at Valence.[29]

The key event which triggers the statute of limitations is the publication of "Story Stock" in February 1993. Dawson's letter to refute "Story Stock" after publication of the article does not, as plaintiff argues, detract from the significance of the information suggesting fraud at Valence having been released into the market.

Plaintiffs' argument that "Story Stock" could not trigger the statute of limitation because it is plaintiffs' expert Torkelson's opinion that the article did not reveal that defendants acted with fraud is not well taken for two reasons: 1) interpretation of Story Stock" is a question of

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[29] *Robuck*, 649 F.2d 641, (9th Cir. 1980); *Davis*, 839 F.2d 1370, (9th Cir. 1988).

law for this Court; and 2) an investor does not have to have notice of the entire fraud to be on inquiry notice.[30]

This action is barred by the one-year statute of limitations of Rule 10(b)5.

Recommendation

For the reasons stated herein, it is recommended that defendants' motion for summary judgment that this action is time-barred by the statute of limitations be granted.

DATED: July 14, 1997

/s/ Paul C. Valentine
Paul C. Valentine
Special Master

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[30] *Dodds v. Cigna Secs., Inc.*, 12 F.3d 346, 351 (2nd Cir. 1993), *cert. den.*, ___ U.S. ___, 114 S. Ct. 1401 (1994).

NOT FOR PUBLICATION
UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

JAMES I. BERRY; JAMES VARANO; GREGG M. WEISS; GREGG M. IRA, F/B/O Weiss; PETER GARUCCIO, M.D.; P.C. PENSION PLAN; FREDERICK JEWETT; MILBURN E. ESTES; JOSEPH P. YONKE; INVESTAR PARTNERSHIP; EUGENE HONEYMAN; ANNE KANTOR; MURRAY GOLDSMITH; MORTON SURKIN; FLORENCE SURKIN; ROBERT LEIMSIDER; GILBERT BERGELSON, on behalf of themselves and all others similarly situated,

Plaintiffs-Appellants,

v.

VALENCE TECHNOLOGY, INC.; LEV DAWSON; CALVIN L. REED; CRISTINE A. RUSSELL; DALE R. SHACKLE; DAVID M. BUTZE; WILLIAM J. MASUDA; CARL E. BERG; ALAN F. SHUGART; BERT C. ROBERTS,

Defendants-Appellees.

No. 97-17346

D.C. No. C-95-20459 JW (EAI)

ORDER

(Filed Jun. 18, 1999)

Before: BRIGHT,[1] B. FLETCHER and THOMPSON, Circuit Judges

The panel has voted unanimously to deny the petition for rehearing and to recommend rejection of the petition for rehearing en banc.

The full court has been advised of the suggestion for an en banc rehearing, and no judge of the court has requested a vote on the petition for rehearing en banc. Fed. R. App. P. 35(b).

The petition for rehearing is denied and the petition for rehearing en banc is rejected.

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[1] Honorable Myron H. Bright, Senior United States Circuit Judge for the Eighth Circuit, sitting by designation.

Supreme Court, U.S.
FILED
OCT 21 1999
OFFICE OF THE CLERK

No. 99-476

In The

Supreme Court of the United States

VALENCE TECHNOLOGY, INC., CARL E. BERG, LEV M. DAWSON, CALVIN L. REED and DALE R. SCHACKLE,

Petitioners,

vs.

JAMES I. BARRY, JAMES VARANO, GREGG M. WEISS, PETER GARUCCIO, M.D., P.C. PENSION PLAN, FREDERICK JEWETT, MILBURNE E. ESTES, JOSEPH P. YONKE, INVESTAR PARTNERSHIP, EUGENE HONEYMAN, ANNE KANTOR, MURRAY GOLDSMITH, MORTON SURKIN, FLORENCE SURKIN, ROBERT LEIMSIDER and GILBERT BERGELSON, On Behalf of Themselves and All Others Similarly Situated,

Respondents.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Ninth Circuit

OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED

Should this Court review the Ninth Circuit's fact-bound holding that, whatever standard governs Securities Exchange Act §9(e)'s limitations period – "actual discovery" or "inquiry notice" – Defendants failed to demonstrate as a matter of law that the facts in this case placed every reasonable investor on notice of fraud more than a year before suit was filed?

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RULE

Federal Rule of Civil Procedure 8(c) 7

MISCELLANEOUS

S. Estriecher & J. Sexton, *A Managerial Theory of the Supreme Court's Responsibilities: An Empirical Study*, 59 N.Y.U.L. Rev. 681 (1984) 7

R. Posner, *The Federal Courts: Crisis and Reform* (1985) 7

I. INTRODUCTION

Defendants' petition asks this Court to review questions that the Ninth Circuit declined to reach because they do not affect the result, in order to resolve a conflict among the circuits that does not in fact exist.

The Ninth Circuit expressly declined to reach the question whether "actual discovery" or "inquiry notice" triggers the running of the statute of limitations of Securities Exchange Act § 9(e), made applicable to § 10(b) claims by this Court's decision in *Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson*, 501 U.S. 350 (1991). All seven courts of appeal that have decided the question the Ninth Circuit avoided ***are in agreement***. Petition at 8.

The subtle differences among them, if any, may lie in their descriptions of the "inquiry notice" standard. Defendants ask this Court to review what amount to trivial differences in ***semantics***. *See, e.g., Sterlin v. Biomune Sys., Inc.*, 154 F.3d 1191, 1200 n.15 (10th Cir. 1998) (surveying the circuits, and concluding that the differences among them are likely "more semantic than substantive").

Defendants simply disagree with the Ninth Circuit's holding that, no matter what the proper legal standard is, they failed to demonstrate as a matter of law that the statute of limitations ran. Review is not warranted for Defendants to re-argue the facts.

II. STATEMENT OF THE CASE

This case is a securities fraud class action brought on behalf of all persons who purchased stock in Valence

Technology, Inc. between May 7, 1992 and August 10, 1994. Plaintiffs alleged that the Company and various individual defendants (collectively, "Defendants") violated federal securities laws by making false and misleading statements about Valence's battery technology.

The Company raised over $115 million in two 1992 public offerings to develop a revolutionary lithium-battery technology. A.4.[1]

In December 1992, Valence publicized a $100 million contract with Motorola, which would use Valence's batteries in its cell phones. *Id.*

On February 15, 1993, *Forbes* magazine published an unflattering article about Valence entitled "Story Stock," that questioned investors' enthusiasm for Valence. A.4-5, A.13. The article noted that several Valence insiders had sold some stock, and that Carl Berg, Valence's largest shareholder, had been involved in two other companies that failed. *Id.* The article also mentioned that Berg had once been accused of fraud in an unrelated civil case that settled. Petition at 4.

Still, the article admitted that the Valence battery " 'works beautifully in the lab.' " *Id.* Its main criticism was that no one – not even *Forbes* – could say for certain whether the batteries could be made commercially: " ***'The world doesn't know.'*** " *Id.* Tellingly, Defendants omit these crucial facts from their Statement of the Case. *See* Petition at 4.

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[1] "A.___" refers to the Appendix to Petition for a Writ of Certiorari.

If the *Forbes* article revealed fraud, no one noticed. In the week after the article was published, Valence's stock dipped only slightly from the $15 mark. A.6. Within days it rose back to $15, and thereafter fluctuated between $17.75 and $11.50 from early March into September when, by month's end, it traded at $20. *Id.* National financial media like *The Wall Street Journal* ran positive stories about Valence. A.6, A.15. Valence successfully completed yet another public offering, this time raising $51.5 million in December 1993. A.6.

Suddenly, on May 3, 1994, Valence announced that it could not meet Motorola's specifications. A.6-7. The market responded immediately, dropping Valence's stock price from $9.50 to $5.25. A.7. When Valence announced on June 16, 1994 that it could not meet Hewlett-Packard's specifications either, Valence's stock price nearly halved itself again, plummeting to $3.813. *Id.* Finally, on August 9, 1994, Valence announced that it was abandoning its "revolutionary" new battery technology altogether. *Id.*

Valence investors filed suit, alleging that Valence's claims about its battery had been false. *Id.* Defendants moved for summary judgment, arguing that investors should have filed suit one year after being put on "inquiry notice" of fraud by *Forbes* in mid-February 1993. Petition at 4-5; A.7. The district court agreed, holding plaintiffs' securities claims time-barred. A.7-8.

The Ninth Circuit reversed, holding that Defendants had not demonstrated as a matter of law that reasonable investors knew or should have known, upon publication of the *Forbes* article, that Valence was a fraud. *See Berry v. Valence Tech., Inc.*, 175 F.3d 699 (9th Cir. 1999), *reprinted at*

A.1-18. The Ninth Circuit explained that, on the factual record presented, it ***did not have to decide*** whether "actual discovery" or "inquiry notice" controls § 10(b) claims – because "under either standard," Defendants had not shown that the *Forbes* article's skepticism was enough to " 'excite inquiry' " by reasonable investors. A.12. The *Forbes* article had simply "raised questions . . . that even the article claimed were largely unanswerable." A.13. At bottom, the article only urged "caution before investing." *Id.*

III. REASONS FOR DENYING THE PETITION

A. The Decision Below Produces No Conflict Among the Circuits

Defendants ask this Court to review questions that the Ninth Circuit did not reach or decide, to resolve a supposed "conflict among the circuits" that does not exist.

They assert that, by suggesting that Exchange Act § 9(e)'s text ***might*** require actual discovery rather than inquiry notice, the decision below conflicts with the law of the other circuits. But the Ninth Circuit expressly declined to reach the issue: "In this case, we need not decide whether actual discovery or inquiry notice applies, because ***under either standard*** the *Forbes* article did not trigger the statute of limitations." A.12 (emphasis added). Defendants emphasize that since this Court's opinion in *Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson*, 501 U.S. 350 (1991), every one of the seven circuit courts to decide the issue has held that "inquiry notice" is the appropriate standard. Petition at 8. Why

they think that the Ninth Circuit's refusal to even reach the issue produces a conflict among the circuits, sufficient to merit this Court's attention, is a mystery.

Nor did the Ninth Circuit adopt an inquiry notice standard that is at odds with the law of the other circuits. All the Ninth Circuit said is this: "***If*** we were to adopt inquiry notice, we would agree with the Tenth Circuit's formulation of that standard." A.11 (emphasis added) (*citing Sterlin v. Biomune Sys., Inc.*, 154 F.3d 1191, 1201 (10th Cir. 1998)). The Court explained that in *Sterlin*, the Tenth Circuit had surveyed the precedents and found that they " 'generally apply an inquiry notice standard coupled with some form of reasonable diligence requirement.' " A.11 (*quoting Sterlin*, 154 F.3d at 1199-1200). "In *Sterlin*'s formulation, 'inquiry notice . . . triggers an investor's duty to exercise reasonable diligence and . . . the one-year statute of limitations period begins to run once the investor, in the exercise of reasonable diligence, should have discovered the facts underlying the alleged fraud.' " A.11 (*quoting Sterlin*, 154 F.3d at 1201).

"Were we to apply the *Sterlin* test to this case," the Ninth Circuit observed, "we would face two questions." A.11-12. "First, did the *Forbes* article raise sufficient suspicion of fraud to cause a reasonable investor to investigate the matter further?" A.12. "Second, when should a reasonably diligent investor have discovered the facts underlying the alleged fraudulent activity?" A.12. The Ninth Circuit then proceeded to apply standard inquiry-notice analysis, drawn from Tenth and Seventh Circuit precedents. *See* A.11-14 & n.8 (*citing Sterlin*, 154 F.3d at 1201-04; *Law v. Medco Research*, 113 F.3d 781, 784-85 (7th Cir. 1997)).

Defendants suggest that the Tenth Circuit's standard in *Sterlin* – that the Ninth Circuit said it might adopt – conflicts with the other circuits' case law. Petition at 8-9. But the supposed conflicts are illusory. *Sterlin* itself surveys the precedents, and concludes that the differences in the circuits' approaches to inquiry notice appear "more semantic than substantive." 154 F.3d at 1200 n.15. What inconsistency there is "may be largely attributable to the fact that in many cases," as here, "the court need not decide exactly when the one-year limitations period began to run, *i.e.*, upon inquiry notice or only when the plaintiff reasonably should have discovered the facts underlying the alleged fraud." *Id.* When the difference matters, the circuit courts have had no difficulty deciding the issue – and their decisions have been consistent. *See, e.g., Sterlin*, 154 F.3d at 1201-02; *Law*, 113 F.3d at 785-86.

Defendants insist that *Sterlin* conflicts with Seventh Circuit law. But *Sterlin* specifically follows Seventh Circuit precedent, noting that "consistent with our holding, a recent case from the Seventh Circuit has recognized that the one-year limitations period should not begin to run until a reasonable investor should have discovered the facts underlying the alleged fraudulent activity." *Sterlin*, 154 F.3d at 1201-02 (*citing Marks v. CDW Computer Centers*, 122 F.3d 363, 367-68 (7th Cir. 1997)). The court acknowledged differences in phraseology, *id.* at 1202 n.19, but pointed out that such differences do not necessarily indicate differences in substance. *Id.* at 1200 n.15.

Review by this Court is hardly needed to iron out minor semantic differences between the circuits' descriptions of inquiry notice. A far better course would be to allow the courts of appeal to continue their fine-tuning of

this standard. *See Brown v. Texas*, 522 U.S. 940, 118 S. Ct. 355, 357 (1997) (Stevens, J.) (writing on denial of certiorari that "the likelihood that the issue will be resolved correctly may increase if this Court allows other tribunals 'to serve as laboratories in which the issue receives further study before it is addressed by this Court' ") (citation omitted).[2]

B. Defendants' Disputes with the Ninth Circuit's Holding Are Factual in Character

What Defendants actually seek is to re-argue the factual record, in order to contest the Ninth Circuit's holding that they failed to show as a matter of law that the *Forbes* article placed all reasonable investors on notice of fraud.

The statute of limitations is an affirmative defense, Fed. R. Civ. P. 8(c), that Defendants had the burden of showing as a matter of law to win their motion for summary judgment. *Vargas v. Cummings*, 149 F.3d 29, 35 (1st Cir. 1998); *Lee v. Sandberg*, 136 F.3d 94, 101 (2d Cir. 1997). The Ninth Circuit concluded that the district court had improvidently granted summary judgment. A.12-15.

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[2] *See also* S. Estriecher & J. Sexton, *A Managerial Theory of the Supreme Court's Responsibilities: An Empirical Study*, 59 N.Y.U.L. Rev. 681, 716 (1984) ("[t]he process of percolation allows a period of exploratory consideration and experimentation by lower courts before the Supreme Court ends the process with a nationally binding rule"); R. Posner, *The Federal Courts: Crisis and Reform* 108 (1985) ("The circuits as well as the states are laboratories.").

The factual record strongly supports the Ninth Circuit's conclusion that Defendants failed to show that reasonable investors were on notice of fraud as a matter of law. The *Forbes* article "made no allegation of actual fraud on the part of Valence or its principals." A.12. It suggested that " 'investors ought to be a little choosier' " before rushing out to buy Valence stock. A.13. There was no "reasonable nexus" between the article's questions about investors' enthusiasm for Valence stock and the nature of the securities fraud action subsequently brought. A.12-13. Section 9(e)'s one-year limitation period is triggered by " 'discovery of the ***facts constituting the violation***,' " 15 U.S.C. § 78i(e), and *Forbes* did not reveal those facts. A.13 (emphasis in original).[3]

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[3] Defendants also claim that the Ninth Circuit's holding that the *Forbes* article " 'made no allegation of actual fraud' " is erroneous in light of the Court's decision in *United States v. Kubrick*, 444 U.S. 111 (1979), which held that it was error to equate a "plaintiff's ignorance of his legal rights and his ignorance of the fact of his injury or its cause." *Id.* at 122 (cited in Petition at 10). But the Ninth Circuit's holding does no violence to *Kubrick*. To the contrary, *Kubrick* actually ***supports*** the Ninth Circuit's holding.

The plaintiff in *Kubrick*, despite being ***aware*** of the existence and cause of his injury, waited until he was told that the injury might have been caused by medical malpractice before filing suit. 444 U.S. at 114. He should have timely filed suit once he was aware of the "critical facts that he [had] been hurt." *Id.* at 122. Plaintiffs in this case did exactly that – timely filing suit once Valence admitted that it could not, in fact, make the batteries as promised, and fill the Motorola contract. A.7. They were not aware of the "existence and cause" of their injuries earlier merely because an unflattering article admitted that ***no one in the world*** knew if Valence would be able to live up to the hype surrounding its battery technology.

Did Valence's battery work as represented? Could it be manufactured commercially as Valence claimed? *Forbes* admitted: " ***'The world doesn't know.'*** " A.13. It was not until months later, when Valence admitted that it could not fulfill its contract with Motorola because its battery did not meet specifications, that investors had reason to suspect fraud – and thereafter timely filed suit. A.7.

Defendants object that the Ninth Circuit improperly considered "facts extraneous to the facts contained in the article itself" by reviewing stock prices, other articles, and the utter lack of any notable negative response to the *Forbes* article. Petition at 11. This is ironic. Defendants themselves presented the district court and Ninth Circuit with the allegedly "extraneous" facts that they now contend should have been ignored. It was Defendants who claimed that the *Forbes* article ***and its aftermath*** should have spurred reasonable investors to investigate further. They placed the evidence of Valence stock prices in the Record.[4] They led the district court to conclude – erroneously – that the article prompted a 40% stock drop. *See* A.27.

Defendants told the Ninth Circuit that investors, after reading the *Forbes* article, would have found even more fodder for their suspicions in other articles, Securities and Exchange Commission filings, and even ***patent filings***. And yet Defendants now argue that the Ninth Circuit should have looked no further than the bare words on *Forbes'* pages while reviewing what confronted

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[4] *See* Ninth Circuit Excerpts of Record 435/A.

reasonable investors. This is both illogical and disingenuous – and certainly does not warrant review by certiorari. Defendants' factual arguments are not the sort of questions this Court need concern itself with. "Questions of fact . . . ought not be recanvassed [by this Court] unless they are entangled in the proper determination of constitutional or other important legal issues." *Dick v. New York Life Ins. Co.*, 359 U.S. 437, 454 (1959).

This is simply not the appropriate case to review a question the Ninth Circuit expressly declined to reach. Manufacturing a nonexistent circuit conflict and attempting to re-argue the correctness of the Ninth Circuit's holding regarding the impact the *Forbes* article had on reasonable investors are not the sort of compelling reasons that justify taking up this Court's time.

IV. CONCLUSION

The petition for a writ of certiorari should be denied.

DATED this 21st day of October, 1999.

Respectfully submitted,

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IN THE

Supreme Court Of The United States

OCTOBER TERM, 1999

VALENCE TECHNOLOGY, INC., CARL E. BERG, LEV M. DAWSON, CALVIN L. REED, DALE R. SHACKLE,

Petitioners,

vs.

JAMES I. BERRY; JAMES VARANO; GREGG M. WEISS; PETER GARUCCIO, M.D., P.C. PENSION PLAN; FREDERICK JEWETT; JILBURNE E. ESTES; JOSEPH P. YONKE; INVESTAR PARTNERSHIP; EUGENE HONEYMAN; ANNE KANTOR; MURRAY GOLDSMITH; MORTON SURKIN; FLORENCE SURKIN; ROBERT LEIMSIDER; GILBERT BERGELSON,
on behalf of themselves and all others similarly situated,

Respondents.

On Petition For A Writ Of Certiorari
To The United States Court Of Appeals
For The Ninth Circuit

BRIEF OF AMICUS CURIAE NATIONAL VENTURE CAPITAL ASSOCIATION IN SUPPORT OF PETITIONERS

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NATIONAL VENTURE CAPITAL ASSOCIATION

Pursuant to Rule 37.2 of the Supreme Court Rules, Amicus Curiae National Venture Capital Association ("NVCA") hereby respectfully submits this brief in support of Petitioners' petition for writ of certiorari.[1] The parties have consented to the filing of this brief, and their written consents are submitted herewith.

INTEREST OF AMICUS CURIAE

NVCA is a national organization dedicated to defining, serving and representing the interests of the venture capital and private equity industries. Formed in 1973 to foster understanding of the importance of venture capital to the vitality of the U.S. economy, NVCA works to stimulate the flow of risk equity capital to emerging and developing companies, including through the public securities markets.

As Congress recognized with its adoption of the Private Securities Litigation Reform Act of 1995 ("PSLRA"),[2] excessive and abusive securities litigation has become a serious burden to the national economy, making it more difficult for emerging and developing companies to raise capital, to attract experienced board members to serve on their boards of directors, to compete internationally and to offer employment opportunities to American workers. *See, e.g.*, H.R. Rep. Conf. No. 104-369, at 32-41 (1995). Moreover, the burden of excessive securities litigation falls disproportionately on relatively less established companies whose fortunes are less predictable and whose stock prices are therefore more volatile. These companies tend to be smaller in terms of market capitalization, and often include emerging technology companies and other businesses involved in innovative

---

[1] No counsel for any party had any role in authoring this brief and no person other than NVCA or its counsel made any monetary contribution to the preparation or submission of this brief.

[2] The PSLRA amends the Securities Exchange Act of 1934 (the "1934 Act"), and applies to private class actions brought pursuant to the Federal Rules of Civil Procedure. *See, e.g.*, 15 U.S.C. § 78u-4(a)(1) (1997).

or risky ventures. Many of the companies that are victims of securities litigation abuse are doing important, innovative work that is vital to the future health of the national economy and to future job creation.

As a representative of the venture capital and entrepreneurial communities, NVCA has a vital interest in the issue raised by this case: what actual or constructive knowledge of the plaintiff is legally necessary to trigger the one-year limitations period for private claims arising under Section 10(b) of the 1934 Act, codified at 15 U.S.C. § 78j(b). A uniform legal standard for triggering the limitations period is essential to curb the filing of opportunistic securities claims. This is especially true given the broad venue provisions of the 1934 Act. *See* 15 U.S.C. § 78aa. These are issues of great concern to the venture capital and private equity industries, and we respectfully submit this brief in order to address them.

REASONS FOR GRANTING THE WRIT

In their petition for writ of certiorari, Petitioners identify two conflicts that exist in the Circuits on the legal standard triggering the statute of limitations for Section 10(b) claims. *See* Pet. at 6-7. These conflicts undermine the uniform limitations period that this Court adopted in *Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson*, 501 U.S. 350 (1991), and increase the likelihood of abusive securities litigation.

The statute of limitations for Section 10(b) claims serves important public purposes. These include finality and predictability in the legal affairs of companies, protecting potential defendants from the burden of having to respond to stale and opportunistic claims, and discouraging investors from adopting a wait-and-see approach. *See Tregenza v. Great American Comm. Co.*, 12 F.3d 717, 722 (7th Cir. 1993) (inquiry notice standard discourages tactic of "[h]eads I win, tails you lose"), *cert. denied*, 114 S. Ct. 1837 (1994); *Volk v. D.A. Davidson & Co.*, 816 F.2d 1406, 1413 (9th Cir. 1987) (the 1934 Act is intended "to protect the innocent investor, not one who loses

his innocence and then waits to see how his investment turns out before he decides to invoke the provisions of the Act"). Indeed, this Court has warned against the abuse of the securities laws that comes from allowing potential plaintiffs to "await developments on the sidelines without risk." *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 747 (1975); *see also Basic, Inc. v. Levinson*, 485 U.S. 224, 256-57 (1988) (White, J., concurring).

These important purposes are defeated by the application of inconsistent legal standards for triggering the one-year limitations period for Section 10(b) claims. *See* Pet. at 7-10. In particular, allowing differing standards to trigger the limitations period increases the risk of opportunistic claims. As Judge Posner has stated:

> Three years is an age in the stock market. If the suspicious investor had a wide choice of times at which to sue within a three-year period rather than being required to sue no more than one year after the earliest possible date, the opportunistic use of federal securities law to protect investors against market risk would be magnified.

Tregenza, 12 F.3d at 722.

There is a particular need for national uniformity in the legal standards applicable to Section 10(b) claims because of the liberal venue provisions of the 1934 Act, *see* 15 U.S.C. § 78aa, which have been read effectively to confer nationwide venue in many investor class actions. *See, e.g., Washington Pub. Utils. Group v. United States Dist. Court*, 843 F.2d 319, 328 (9th Cir. 1988). The differing standards that inform the question of when the one-year limitations period begins to run in different Circuits, *see* Pet. at 7, raise the specter of one district court permitting a Section 10(b) claim to go forward despite the fact that the identical claim would be time-barred in another district. Such a result can only promote forum shopping and is entirely inconsistent with the uniform limitations period that this Court adopted in *Lampf*.

CONCLUSION

For all of the reasons stated herein and in Petitioners' petition for writ of certiorari, amicus respectfully urges the Court to grant that petition and permit full briefing on the merits.

DATED: October 21, 1999

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In The

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Respondents.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Ninth Circuit

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SUMMARY

Three matters raised in the Opposition Brief confirm the existence of matters suitable for, indeed demanding, this Court's review.

First. Respondents ignore the conflict between the Second Circuit's inquiry notice standard, which is prospective and can be practically applied by lawyers and potential litigants, and the retrospective standards of the Seventh and Tenth Circuits, which can only be discerned by litigants when applied by a reviewing court. Opposition ("Opp.") 6. This case presents a straightforward opportunity for this Court to choose a rule.

Second. Respondents admit at one point that the Ninth Circuit held that the *Forbes* article could not constitute the "discovery of the facts constituting the violation" because the article "made no allegation of actual fraud." (Opp. 8 & n.3). But Respondents' attempt to reconcile this holding to *United States v. Kubrick*, 444 U.S. 111 (1979), is both unsupported and unbelievable. *Kubrick* holds that it is reversible error to link the onset of a limitations period to the plaintiff's knowledge of the legal consequences of the facts of injury and causation. *Id.* at 122. The Ninth Circuit plainly committed this mistake, and thereby departed from this Court's jurisprudence, exemplified by *Kubrick*.

Third. Apart from their treatment of *Kubrick*, Respondents repeatedly misstate the Ninth Circuit's holding in this case in an effort to make the holding appear less radical than it is. The trial court examined *Forbes* and held as a matter of law that the article would put *any* reasonable person on notice. The Ninth Circuit looked at the same article and held that *no* reasonable person could read it and suspect fraud. Appendix ("App.") 12. Respondents, however, inaccurately suggest that the Ninth Circuit merely held that Petitioners failed to carry their burden of proof to show that *Forbes* necessarily triggered

the limitations period for the "fraud" later alleged. Opp. 7. The obviously consequential difference is that between failing to establish an affirmative defense as a matter of law (in which case a jury question would remain), and what happened here – where the defense was summarily decided in the Court of Appeals in favor of Respondents, although they made no motion for summary judgment.

In taking the issue of notice from a jury, and in departing from principles exemplified by *Kubrick*, the Ninth Circuit necessarily adopted a standard of notice that is more onerous for defendants than any other prevailing in the Courts of Appeals. This case squarely puts the proper legal standard of notice at issue.

THE CIRCUIT CONFLICT

Respondents contend the petition rests on trivial word play among the Courts of Appeals. Not so. At issue is an outcome-determinative debate about the meaning of the words this Court used to define the statute of limitations for claims arising under Securities Exchange Act Section 10(b): "the discovery of the facts constituting the violation." *Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson*, 501 U.S. 350, 364 & n.9 (1991).

The circuits are in conflict about what "discovery" encompasses: is the purpose of the one-year limitations period to permit a potential litigant to investigate and promptly file a claim, or is a plaintiff given a year after all of the claim's pieces are in place to see if litigation is attractive?

The Second and Fourth Circuits take the former view. *Dodds v. Cigna Securities, Inc.*, 12 F.3d 346, 351 (2d Cir. 1993), *cert. denied*, 511 U.S. 1019 (1994); *Cooke v. Manufactured Homes, Inc.*, 998 F.2d 1256, 1263 (4th Cir. 1993). This was surely the rule in the Ninth Circuit prior to *Lampf*. *Davis v. Birr, Wilson & Co.*, 839 F.2d 1369, 1370 (9th Cir. 1988); *Volk v. D.A. Davidson & Co.*, 816 F.2d 1406 (9th Cir.

1987). It was the rule applied by the District Court. App. 30-32.

The Seventh Circuit has its own test, which looks at the confluence of suspicious circumstances and the ease of access to information that can confirm the suspicions by a reasonably diligent investigation. *Fujisawa Pharm. Co., Ltd. v. Kapoor*, 115 F.3d 1332, 1334 (7th Cir. 1997). The Seventh Circuit recognized the possibility of commencing the one-year period at the point apparently fixed by the Ninth Circuit here, when "the victim has in hand all the facts he needs to bring suit immediately," but rejected that view as "untenable." *Id.* The investor should not be permitted to "complete his investigation, draft his complaint, and put the complaint in a drawer to be taken out in a year and filed if the price of the stock has fallen." *Id.*

The Ninth Circuit has now taken a contrary, indeed unique, view. Apparently taking *Lampf* as an opportunity to evade its own inquiry notice precedent (App. 8), the Ninth Circuit says that the one-year limitations period *starts* only *after* the plaintiff's investigation should have collected the facts "underlying the alleged fraud." App. 11. How the facts "underlying the alleged fraud" may differ from "the facts constituting the violation" is unclear, but the Ninth Circuit's vague test appears to offer a plaintiff poised to sue at least a year (depending on when a court finally decides "discovery" occurred) to see if a risky investment in a volatile technology stock will pay off or fail. The Seventh Circuit calls this rule "Heads I win, tails you lose." *Tregenza v. Great American Comm. Co.*, 12 F.3d 717, 722 (7th Cir. 1993), *cert. denied*, 511 U.S. 1085 (1994).

That the differences between these tests are not "semantic" can be easily illustrated here (assuming that the *Forbes* disclosures are legally sufficient to excite inquiry, as the District Court concluded). Under the Second Circuit's test, the year commences on the publication

of *Forbes*, and this lawsuit was untimely. Under the formulation of the Seventh Circuit's test in *Fujisawa*, the year begins when suspicion is aroused, provided that the facts necessary to file a complaint could have been assembled within a year of aroused suspicion. Under the test endorsed by the Ninth Circuit, however, the year apparently does not even start until the time it would end in the Seventh Circuit. App. 11.[1]

The Ninth Circuit does not stop by formulating its own distinctive test of notice. Based on a three-sentence analysis, the court says that when this Court picked Exchange Act Section 9(e)'s limitations provision for Section 10(b) claims it "explicitly chose a provision requiring actual discovery over other provisions allowing inquiry notice. . . . " App. 9. The Ninth Circuit left wholly unaddressed Justice Kennedy's dissenting observation that the Court "does not identify any reasons for finding one [of the two formulations of the relevant, borrowed statute of limitations] to be controlling." *Lampf*, 501 U.S. at 375. Per the Ninth Circuit, however: "*Lampf* does appear unequivocal on this point. . . . " App. 8. No other circuit thinks so.

The Ninth Circuit's attempt to resolve this case while professing not to decide the governing notice standard fails. The Court necessarily applies a notice standard that is less favorable to defendants, as we now show.

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[1] There appear to be other conflicts as well. In the Ninth Circuit, inquiry notice imposes on plaintiffs the burden of creating a triable factual issue with evidence that they failed to discover the fraud despite the exercise of reasonable diligence. *See, e.g., Briskin v. Ernst & Ernst*, 589 F.2d 1363, 1366 n.3 (9th Cir. 1978). Respondents here did not. In the Seventh Circuit, it may be defendants' burden to show that diligence would lead to discovery. *Law v. Medco Research, Inc.*, 113 F.3d 781, 786 (7th Cir. 1997).

THE NINTH CIRCUIT'S ERRORS

Lampf ties the onset of the statutory period to the discovery of "the facts constituting the violation." Focus on what must be "discovered" illuminates the timeliness of the issue presented for this Court's review and resolution. In order to understand the proper presentation of that issue, we take a closer look at the Ninth Circuit's errors.

Respondents repeatedly suggest that the Ninth Circuit merely held that petitioners had failed to carry a burden of proof establishing an affirmative defense as a matter of law. Opp. 1, 3, 7. Not so. The Ninth Circuit held that the *Forbes* article did not help arouse suspicion of fraud as a matter of law. App. 15. Generically applied to this record, this viewpoint means that facts suggesting that big contracts and products are not what the company claims, presented alongside charges that "insiders" elsewhere "accused of securities fraud" are "unloading" shares in a company with a "levitated" stock price *would not* lead any reasonable reader to suspect anything that might eventually suggest a claim for securities fraud. App. 13-15. The Ninth Circuit had to come to this remarkable and unsupportable conclusion to avoid squarely facing the notice question.

In reaching this conclusion, the Ninth Circuit did something *other* than evaluate whether *Forbes* disclosed "the facts constituting the violation" alleged. The Ninth Circuit erroneously decided the notice effect of *Forbes* by considering one possible conclusion of an investigation of its charges. Respondents suggest that the Ninth Circuit did not err in looking to extraneous facts to determine whether *Forbes* constituted notice of the alleged fraud, arguing that defendants invited the court to engage in just such an exercise. Opp. 9. But Respondents fail, as did the Ninth Circuit, to distinguish in practice the two phases of the limitations analysis identified by the court. First, does the matter alleged to constitute notice arouse a suspicion of

fraud that would cause a reasonable person to investigate that possibility? Second, would a reasonable investigation uncover facts sufficient to permit the filing of a complaint? App. 11-12.

The Ninth Circuit erroneously collapsed these questions. The court reasoned that the article would not induce a reasonable investor to investigate the possibility of fraud, because reliance on a few of the facts that might be collected during such an investigation could support a conclusion other than fraud. App. 13-15. In other words, *Forbes* would not provoke a shareholder to investigate, because the investigation might lead to an innocuous conclusion. App. 15. This species of circular reasoning is not only inarguably a fallacy, it is easily and completely distinguishable from the analysis that was urged on the courts below by Petitioners: whether factual confirmation of a suspicion aroused is readily available. Instead of analyzing whether a reasonably diligent investigation could have turned up facts confirming suspicions aroused by *Forbes* (as the District Court did), the Ninth Circuit erroneously concluded that if an investigation might possibly support an innocent explanation, then notice does not exist.

This error ties closely to another, decisive mistake, the existence of which Respondents admit in the course of trying to deny it: the Ninth Circuit held that *Forbes* could not provide notice of possible fraud because it "made no allegation of actual fraud." App. 12; Opp. 8. Claiming that the "factual record strongly supports the Ninth Circuit's conclusion," Respondents can only repeat the conclusion. Opp. 8.

Respondents then attempt to distinguish or dismiss *United States v. Kubrick*, in which this Court corrected precisely the error made by the Ninth Circuit here. Respondents first suggest that the Ninth Circuit did not run afoul of *Kubrick* because Respondents were not aware of their injury and its likely cause until Valence announced in May, 1994 that it could not build batteries to Motorola's

then-existing specifications. Opp. 8, n.3. If this is a factual assertion, it has no support in the record. If it is an argument, the facts indicate its absurdity: credulous shareholders (who did not, and indeed could not, suspect fraud prior to Valence's May 3 announcement) first suspected fraud out of a clear blue sky, and that day hired lawyers, who drafted and filed class action fraud complaints mere hours later. App. 6-7.

Respondents' argument further ignores the nature of their claims. This class action securities claim rests on the "fraud on the market" theory. That theory holds that investors are injured when they buy shares of stock at prices artificially inflated by actionable misstatements or omissions. *Basic, Inc. v. Levinson*, 485 U.S. 224, 245 (1988). The injury does not occur when the artificial inflation is allegedly purged from the stock price by the market's reaction to some later revelation. *Eckstein v. Balcor Film Investors*, 8 F.3d 1121, 1127-28 (7th Cir. 1993) ("[d]iscovering that one has lost money is not the same as discovering that one has been defrauded"). As petitioners noted, and as Respondents ignore, it was exactly this alleged injury (artificial inflation in the stock price) and its likely cause (allegedly misleading statements made by persons standing to profit from sales of the stock) that *Forbes* identified: *Forbes* indicated that "the Motorola purchase order, which boosted the stock 4$^{3}/_{8}$ points when it was announced in December" was "much less than meets the eye," because it was not a firm commitment, but merely a contingent purchase order. App. 25. That December announcement of the contract contained the statement "the significance of the Motorola agreement can't be overestimated;" when Respondents finally sued, they claimed that this very statement had fraudulently inflated Valence's stock price for precisely the reason "disclosed" by *Forbes*. App. 35.

The District Court correctly followed the trail leading from the *Forbes* article to this lawsuit, concluding that "the facts disclosed and charges leveled by *Forbes* bear nearly a

one-to-one correspondence to the allegations of Plaintiffs' original complaint." App. 35. *Forbes* thus disclosed in February, 1993 the "facts" constituting the "violation" alleged in May, 1994. For the Ninth Circuit, however, this was not enough, because the article "made no allegation of actual fraud." App. 12. This is the error that caused this Court to reverse the Third Circuit in *Kubrick*, and the Court should grant certiorari to do the same here.

Before *Lampf*, the Ninth Circuit held the view that the "purpose of the Securities Exchange Act is to protect the innocent investor, not one who loses his innocence and then waits to see how his investment turns out before he decides to invoke the provisions of the Act." *Volk*, 816 F.2d at 1413. The rule was that "investors must bring their lawsuits when they should discover that they paid an inflated price for securities as a result of misleading statements or omissions." *Id.* at 1414. "[A]ctual or inquiry notice that a fraudulent misrepresentation has been made" was sufficient. *Id.* at 1412. That view was consistent with this Court's precedent. The Exchange Act "was designed to protect investors against manipulation of stock prices." *Basic, Inc.*, 485 U.S. at 230. It should not permit prospective litigants to "await developments on the sidelines without risk." *Blue Chip Stamps v. Manor Drug Store*, 421 U.S. 723, 747 (1975).

The Ninth Circuit opinion below takes *Lampf* to displace this precedent with a rule that gives investors – if they are ever on notice – a year to play the market. No good purpose is served by a rule that invites the "opportunistic use of federal securities law to protect investors against market risk." *Tregenza*, 12 F.3d at 722. Review is thus necessary to determine whether, as Respondents suggest, traditional notions of inquiry notice in the Ninth Circuit in fact survive this Court's decision in *Lampf*, or whether, as the court below held, *Lampf* means that the statute of limitations on a Section 10(b) claim cannot begin

to run unless a prospective plaintiff is first hit over the head with an "allegation of actual fraud."

THIS CASE NECESSARILY PRESENTS FOR REVIEW THE ISSUE OF THE PROPER TEST OF NOTICE

No matter what it claims to have done, the Ninth Circuit necessarily adopted and applied a standard of notice, because it held that *Forbes* could not constitute notice. That standard is more onerous than the aroused suspicion and inquiry standards of the Second and Fourth Circuits, and more onerous than the Seventh Circuit's test, which includes a look at the opportunity available to acquire additional information through investigation once suspicion is aroused. The Ninth Circuit's inquiry notice standard, contrary to every other circuit, requires allegations of actual fraud and facts that, once investigated, would only tend to confirm the conclusion that fraud exists.

As shown above, the Ninth Circuit did not merely hold that Petitioners had failed to carry their burden of proof to establish an affirmative defense, as Respondents inaccurately claim. If that had been the case, there would have remained an issue of fact for a jury, and the Ninth Circuit would have had to remand to the trial court with instructions. It did not. App. 15, n.9. What the Ninth Circuit did instead was to take it upon itself to grant judgment as a matter of law in favor of Respondents, who neither made nor supported such a motion in the trial court. Thus, the Ninth Circuit necessarily created and applied a rule of law on notice that conflicts with the rule in other circuits.

In this connection, Respondents argue that Petitioners want to re-argue facts to this Court. Petitioners, however, seek only this Court's review of the legal significance of a manageable and narrowly defined set of facts: what was disclosed in the *Forbes* article, what was later alleged by Respondents to constitute fraud, the time elapsing between the two events, and the record presented on this

issue at summary judgment. This is nothing like the invitation the Court declined in *Klehr v. A.O. Smith Corp.*, 521 U.S. 179, 193 (1997) (Civil RICO).

CONCLUSION

Offering a time-honored reason for denying certiorari, Respondents argue that this Court should permit *Lampf* to "percolate" so that the circuits can "fine-tune" purportedly inconsequential variations in their inquiry notice standards. Opp. 6-7. This Court has not dismissed the differences in the circuits' discovery rules so lightly, and has indeed indicated that it might review a case where the issues mattered and were presented sharply. *Klehr*, 521 U.S. at 191-193. There is no reason why this Court should permit the Ninth Circuit's decision to cast a shadow of doubt over the application of the discovery rule or to obfuscate material differences among the circuits on the application of the discovery and inquiry notice principles.

Petitioners sought and were denied rehearing and *en banc* review. They are now left with no alternative but to ask this Court to correct the Ninth Circuit's errors. The petition for certiorari to the Court of Appeals for the Ninth Circuit should be granted.

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Respectfully submitted,

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